Supreme Court, U.S.
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In The
Supreme Court of the United States

SANDWICH CHEF OF TEXAS, INC. D/B/A
WALL STREET DELI,

Petitioner,

v.

RELIANCE NATIONAL
INDEMNITY COMPANY, *ET AL.*,

Respondents.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The district court ordered and held a five day eviden tiary class certification hearing, after which it certified a class of policyholders to pursue claims of overcharging against one hundred and forty-four insurance carriers under the Racketeer Influence and Corrupt Organizations Act, 18 U.S.C. §§ 1964-1968 (RICO). The court of appeals reversed, holding that individualized issues of proof defeated predominance. It requires that policyholders must individually prove reliance and that the class cannot establish proximate cause by proving that Respondents' deceit of regulators allowed them to overcharge. As fact, the court of appeals found that some policyholder negotiated and agreed to pay a rate above the filed rate. This fact was contrary to what the district court found and was supported only by material not admitted at the certification hearing. This case presents four questions:

1. Whether a class of insurance policyholders who were directly injured by a RICO conspiracy involving predicate acts of mail and wire fraud can establish proximate cause without proving "reliance." Five circuits require "reliance," while five others do not.

2. Whether a class of insurance policyholders who were directly injured by a RICO conspiracy involving predicate acts of mail and wire fraud can establish proximate cause by showing that they were targets of a RICO conspiracy to defraud state regulators. Three circuits require that the person injured and deceived be the same, while six others do not.

QUESTION PRESENTED – Continued

3. Whether a policyholder's agreement to a rate defeats a RICO claim when the policyholder cannot know that the agreed rate has not been presented to or approved by state regulators, was unlawful, and was the result of a racketeering conspiracy. The court of appeals concluded that a policyholder's simple understanding that they were agreeing to pay more than the filed rate defeated reliance.

4. Whether, the court of appeals violated the Due Process Clause of the Fifth Amendment to the United States Constitution by ignoring the facts found by the district court and finding a contested "fact" supported solely by unidentified non-evidence that the petitioner had no opportunity to challenge or rebut.

RULE 29.6 STATEMENT

Pursuant to Supreme Court Rule 29.6, petitioner states that it has neither a parent company nor a wholly owned subsidiary.

LIST OF ALL PARTIES

The petitioner, Sandwich Chef of Texas, Inc. n/k/a Wall Street Deli, Inc., a debtor in possession, was the appellee below, individually and as a representative of a class of persons similarly situated.

The respondents in this Court, appellants below, are: American Home Assurance Company; Birmingham Fire Insurance Company of Pennsylvania; Commerce and Industry Insurance Company; Granite State Insurance Company; Illinois National Insurance Co.; The Insurance Company of the State of Pennsylvania; National Union Fire Insurance Company of Pittsburgh, PA; New Hampshire Insurance Company; Argonaut Insurance Company; Argonaut-Midwest Insurance Company; Argonaut-Southwest Insurance Company; Chubb Indemnity Insurance Company; Chubb Lloyds Insurance Company of Texas; Federal Insurance Company; Great Northern Insurance Company; Northwestern Pacific Indemnity Company; Pacific Indemnity Company; Sun Insurance Office of America, Inc.; Texas Pacific Indemnity Company; Vigilant Insurance Company; Bankers Standard Insurance Company; Century Indemnity Company; ACE Fire Underwriters Insurance Company f/k/a CIGNA Fire Underwriters Insurance Company; ACE American Insurance Company f/k/a CIGNA Insurance Company; ACE Insurance Company of Texas f/k/a CIGNA Insurance Company of Texas; ACE Property & Casualty Insurance Company f/k/a CIGNA Property & Casualty Insurance Company; Indemnity Insurance Company of North America; Insurance Company of North America; Pacific Employers Insurance Company; American Casualty Company

LIST OF ALL PARTIES – Continued

of Reading, Pennsylvania; Boston Old Colony Insurance Company; Casualty Insurance Company of Texas; Commercial Insurance Company of Newark, New Jersey; Continental Casualty Company; The Continental Insurance Company; The Fidelity and Casualty Insurance Company New York; Firemen's Insurance Company of Newark, New Jersey; The Glens Falls Insurance Company; Kansas City Fire and Marine Insurance Company; National Fire Insurance Company of Hartford; Niagara Fire Insurance Company; Transcontinental Insurance Company; Transportation Insurance Company; Valley Forge Insurance Company; International Insurance Company; The North River Insurance Company; United States Fire Insurance Company; Westchester Fire Insurance Company; EMCASCO Insurance Company; Employers Mutual Casualty Company; American Automobile Insurance Company; The American Insurance Company; Associated Indemnity Corporation; Fireman's Fund Insurance Company; Fireman's Fund Insurance Company of Texas; Fireman's Fund Insurance Company of Wisconsin; National Surety Corporation; Agricultural Insurance Company; American Alliance Insurance Company; American National Fire Insurance Company; Great American Insurance Company; Mid-Continent Casualty Company; Aberdeen Insurance Company; Highlands Casualty Company; Highlands Insurance Company; Highlands Underwriters Insurance Company; Home Insurance Company f/k/a City Insurance Company, Home Indemnity Company, Home Insurance Company and Home Insurance Company of Indiana; Industrial Indemnity Company; American Manufacturers Mutual Insurance Company; American Motorists Insurance Company; American

LIST OF ALL PARTIES – Continued

Protection Insurance Company; Lumbermens Mutual Casualty Company; Liberty Insurance Corporation; Liberty Mutual Fire Insurance Company; Liberty Mutual Insurance Company; Assurance Company of America; Maryland Casualty Company; Maryland Insurance Company f/k/a American General Fire and Casualty Company; Northern Insurance Company of New York; Valiant Insurance Company; Farmland Mutual Insurance Company; Nationwide Agribusiness Insurance Company; Nationwide Indemnity Insurance Company; Nationwide Mutual Fire Insurance Company; Nationwide Mutual Insurance Company; Nationwide Property and Casualty Insurance Company; Scottsdale Indemnity Company; Bituminous Casualty Corporation; Bituminous Fire and Marine Insurance Company; Great West Casualty Company; International Business & Mercantile Reassurance Company; Old Republic Insurance Company; The Connecticut Indemnity Company; Fire and Casualty Insurance Company of Connecticut; Security Insurance Company of Hartford; Reliance Insurance Company; Reliance Lloyds; Reliance National Indemnity Company f/k/a Planet Insurance Company; Reliance National Insurance Company; United Pacific Insurance Company; American and Foreign Insurance Company; Globe Indemnity Company; Royal Indemnity Company; Royal Insurance Company of America; Safeguard Insurance Company; Middlesex Insurance Company; Sentry Insurance, A Mutual Company; Fairmont Insurance Company; TIG American Specialty Insurance Company f/k/a Chilton Insurance Company; TIG Insurance Company f/k/a Transamerica Insurance Company; TIG Insurance Company of Texas f/k/a Transamerica Insurance Company of Texas; TIG Premier Insurance

LIST OF ALL PARTIES – Continued

Company f/k/a Transamerica Premier Insurance Company; Atlantic Insurance Company; The Automobile Insurance Company of Hartford, Connecticut; The Charter Oak Fire Insurance Company; Farmington Casualty Company; Gulf Group Lloyds; Gulf Insurance Company; The Nippon Fire/Marine Insurance Company, Ltd., U.S. Branch; The Phoenix Insurance Company; Select Insurance Company; The Standard Fire Insurance Company; Travelers Casualty and Surety Company f/k/a Aetna Casualty and Surety Company; Travelers Casualty and Surety Company of America f/k/a Aetna Casualty & Surety Company of America; Travelers Casualty and Surety Company of Illinois f/k/a Aetna Casualty & Surety Company of Illinois; The Travelers Indemnity Company; The Travelers Indemnity Company of America; The Travelers Indemnity Company of Connecticut f/k/a The Travelers Indemnity Company of Rhode Island; The Travelers Indemnity Company of Illinois; The Travelers Insurance Company; Fidelity and Guaranty Insurance Underwriters, Inc.; United States Fidelity and Guaranty Company; Republic-Franklin Insurance Company; Utica Mutual Insurance Company; Utica National Insurance Company of Texas; Employers Insurance of Wausau, A Mutual Company; Wausau Business Insurance Company; Wausau Underwriters Insurance Company; American Guarantee and Liability Insurance Company; American Zurich Insurance Company; and Zurich Insurance Company.

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OPINIONS BELOW

The Fifth Circuit's opinion is at 319 F.3d 205. The district court's order granting class certification is at 202 F.R.D. 484 and its order denying Respondents' summary judgment motions is at 111 F. Supp.2d 867.

JURISDICTION

The district court had jurisdiction under Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1994) (RICO), and 28 U.S.C. § 1331 (1993). After the district court certified a plaintiff class, the Fifth Circuit granted Respondents leave to appeal under FED. R. CIV. P. 23(f), entered judgment on January 21, 2003, and denied a timely petition for rehearing on February 27, 2003. This Court has jurisdiction under 28 U.S.C. § 1254(1) (1993).

RELEVANT PROVISIONS INVOLVED

The Appendix contains the relevant sections of RICO, 18 U.S.C. §§ 1961-1968 (App. 116-117); Frauds and swindles, 18 U.S.C. § 1341 (App. 115); Fraud by wire, 18 U.S.C. § 1343 (App. 115); FED. R. CIV. P. 52(a) (App. 111); FED. R. EVID. 101 (App. 112); FED. R. EVID. 1101 (App. 112).

STATEMENT

This case concerns an insurance fraud of enormous size and importance. One hundred forty-four insurance companies deceived policyholders and regulators in forty-four states and the District of Columbia with the object of charging more for workers' compensation insurance than the law allowed. The fraud succeeded.

Wall Street brought this lawsuit to force Respondents to disgorge their unlawful gains. The district court found that the complaint states a cause of action under RICO and that the summary judgment evidence warrants a jury trial. App. 88-104. The district court also certified a policyholder class,

finding that the written misrepresentations, insurance policies and state rate regulations are uniform, and that common evidence can prove the racketeering conspiracy, causation and injury.

A. Respondents' scheme to defraud insurance regulators and policyholders.

Each class member purchased an "Option V" workers' compensation insurance policy. Option V policies are uniform. All contain standard endorsements that set a single formula for calculating premiums.

Forty-five jurisdictions allow Respondents to sell Option V policies. All require Respondents to obtain regulatory approval for Option V rates. Approved rates are called "filed rates." No jurisdiction allows any Respondent to charge more than the filed rate.[1]

Respondents thought the filed rates were inadequate, so they conspired to charge more. Their scheme was simple. Respondents operate the National Council on Compensation Insurance, Inc. ("NCCI"), a trade organization. States rely on NCCI to verify Respondents' use of filed rates. It is obligated to advise the states of noncompliance with rating laws. Knowing this, Respondents sent NCCI Option V policies that contained the lawful filed rates, instead of the unlawful higher rates Respondents were actually charging. NCCI's staff reviewed Respondents' phony policies, and on finding compliance, filed them with the states. App. 36. NCCI also filed other false statements assuring regulators that Respondents were complying with filed rates when they were not. App. 62. NCCI actively supported and hid Respondents' efforts to deceive regulators when it was supposed to keep Respondents honest.

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[1] "The testimony of the experts and fact witnesses at the certification hearing was unanimous on this point: **Defendants cannot charge more than the filed rate.**" App. 47 (emphasis in original); *see also* App. 56-57.

NCCI knew the policies it received from Respondents and filed with the states contained phony rates because *Respondents' officers* staffed NCCI's board of directors and committees. Respondents' officers knew their companies and others were charging unlawful rates and filing phony policies. They used NCCI meetings to launch and coordinate their scheme. They shared schedules showing their inflated charges to ensure parity and prevent policyholders from buying Option V coverage at lawful rates. Respondents used NCCI, a legitimate organization with vast resources, contacts with regulators, and policing powers, to pursue an illegal end. RICO exists precisely to deter this sort of racketeering.[2]

The district court found that Respondents needed NCCI's deceptive filings to keep state regulators from shutting down their scheme. App. 63. No one denies that state regulators would have stopped Respondents from overcharging had they been aware of the fraud. App. 63. The district court also found evidence that Respondents' scheme injured all class members directly and in the same way. App. 63-64, 66.

Respondents also duped policyholders, selling them policies that represented, in writing, that they would charge filed rates. The policies actually contained deviant rates that exceeded the filed rates. Respondents never sought regulators' approval before billing deviant rates, even though their first bills went out 18 months after the policies were sold. By using unapproved rates, Respondents prevented regulators from doing their job: protecting policyholders from excessive and discriminatory rates. Policyholders were entitled to rely on Respondents' invoices as statements of lawful charges. Respondents'

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[2] "The prototypical RICO case is one in which a person bent on criminal activity seizes control of a previously legitimate firm and uses the firm's resources, contacts, facilities, and appearance of legitimacy to perpetrate more, and less easily discovered, criminal acts. . . ." *Fitzgerald v. Chrysler Corp.*, 116 F.3d 225, 227 (7th Cir. 1997).

scheme deprived policyholders of a primary purpose and benefit of regulation, namely, the assurance of state officials that Respondents' rates were appropriate.

B. After an evidentiary certification hearing, the district court certified the class.

At a status conference, Wall Street urged the district court to decide class certification on papers, without an evidentiary hearing. Respondents objected. They demanded an "***evidentiary*** hearing" and pledged to make an "***evidentiary*** presentation," R38:4:25-5:15, 7:3-7 (emphasis added). Respondents prevailed. The district court "t[old] both sides, we will have an ***evidentiary*** hearing," R38:5:16-17 (emphasis added). "[T]he Court [then] conducted an ***evidentiary*** class certification hearing from January 8 through January 12, 2001." App. 37 (emphasis added). The parties proffered exhibits and testimony, made objections and offers of proof, and obtained rulings from the district court. The district court certified the class, App. 35-80, publishing an opinion that cites only "***evidence*** at the certification hearing."[3]

The order certified the class on two RICO theories. The first theory, called the "target" theory, addresses Respondents' efforts to overcharge policyholders by using the NCCI to deceive state regulators. The second theory, called the invoice theory, addresses Respondents' use of fraudulent bills.

When certifying a class on the target theory, the district court applied *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), finding (1) that Respondents' "scheme" caused a "*direct injury*" to Wall Street and other policyholders, App. 100 (emphasis added), 63-64; (2)

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[3] App. 62 (emphasis added); *see also* App. 72 ("The testimony of the experts and fact witnesses at the certification hearing . . . ."); App. 51 ("Professor John C. Coffee, Jr. . . . testified. . . ."); App. 62 ("evidence at the certification hearing provided further details . . . ."); App. 67 ("Wall Street also presented evidence that Defendants knowingly . . . .").

that "[r]eliance upon a fraudulent representation or omission by a third person – here, regulators – is sufficient to state a RICO claim if the plaintiffs is [sic] injured as a result," App. 61; and (3) that "[t]he fraud-on-the-regulator theory is a common issue faced by all class members that may be proved or disproved at trial from a common set of facts under a single federal law [RICO]," App. 63-64. The district court also noted that "[o]ther circuits have accepted the target analysis, particularly where the fraud is perpetuated upon a regulator for the purpose of defrauding a protected class." App. 61.

On Wall Street's invoice theory, the district court observed that Respondents' inflated bills were direct misrepresentations that failed to disclose that Respondents "had not made the necessary filings to allow the deviant charges. Absent such filings, [Respondents] could not lawfully charge the amount invoiced." App. 67. Admitted evidence showed that Respondents "knowingly sent policyholders invoices that [Respondents] knew were higher than the filed rates *at the time the invoices were sent* and that these practices were established in [their] manuals." App. 67 (emphasis added). Policyholders' payment of overcharges provided class-wide, circumstantial evidence of reliance. App. 70-71.

The district court rejected Respondents' contention that their defenses raised individual issues relating to policyholders' knowledge. Respondents claimed that policyholders agreed to pay deviant rates. App. 75-76. This, they asserted, meant that policyholders were *in pari delicto* with them and that a jury would have to assess policyholders' knowledge individually, thus defeating predominance. App. 76.

The district court disagreed. First, it found that policyholders' agreements to pay deviant rates had no bearing on the fraud alleged, which was that Respondents failed to disclose the lack of regulatory approval for deviant rates *when billing*. App. 76.

Second, the district court found "no evidence" that policyholders possessed any relevant knowledge or information about the legality of Respondents' bills. Only Respondents knew whether regulators approved their rates before

their bills were mailed. Even Marsh & McLennan, one of the world's largest insurance brokers, had "no access" to "[t]he approved rates that a state would offer to a given carrier." SuppR2:21:12-22:16, 70:21-71:9. Respondents offered no evidence that any policyholder or broker had the resources to spot illegal charges. To the contrary, they argued that calculating lawful premiums was an especially daunting task.

Although Respondents' officers knew their deviant charges were unlawful, Respondents' witnesses all denied sharing this information with policyholders. They testified that the charges in the bills were *lawful* because policyholders agreed to pay them. This is Respondents' official position too. They deny unlawfully overcharging. Respondents cannot simultaneously maintain that their charges were *lawful* and that policyholders knew their charges were *unlawful*.

The district court rejected Respondents' contention that their defenses required individualized assessments of policyholders' knowledge, stating: "***No evidence*** of any class member's involvement in the alleged scheme was presented to this Court in the certification hearing." App. 76 (emphasis added). A policyholder that knowingly paid an illegal charge would have been involved in Respondents' scheme by helping Respondents circumvent regulators and state laws requiring them to charge filed rates.

C. The Fifth Circuit decertified.

On interlocutory appeal, the Fifth Circuit decertified the class. As to the invoice theory, it found that individual issues of reliance undermined predominance. Its decision rests partly on the legal point that "[k]nowledge that invoices charged unlawful rates . . . would eliminate reliance and break the chain of causation," App. 25, and partly on the factual point that an unstated number of

policyholders "were aware that carriers were charging them more than the filed rate." App. 17.[4]

In finding the quoted "fact," the Fifth Circuit did ***not*** rely on admitted evidence. No admitted evidence demonstrated that any policyholder knew its carrier's charges were unlawful, as the district court plainly said. App. 76. Instead, the Fifth Circuit relied on non-evidence, *i.e.*, "prehearing filings" and items Respondents "proffered" at the hearing without getting the district court to rule on their admissibility. App. 17.[5] The Fifth Circuit said nothing more specific about these items than this.

No one can identify the items the Fifth Circuit relied on. The "prehearing filings" are 34 volumes containing over 12,000 pages, plus 8 boxes holding thousands of pages of sealed documents. Respondents never offered the vast majority of these "prehearing filings" as evidence at the certification hearing, so the district court never ruled on their admissibility. The "proffer[s]" are 211 unadmitted exhibits that Respondents marked for the hearing, but on which they failed to obtain rulings. Wall Street objected to these items when Respondents offered them *en masse* at the start of the evidentiary hearing. The district court refused to admit them at that time. Respondents then failed to offer these 211 exhibits individually later in the hearing. Consequently, *the district court never ruled on Wall Street's objections or the exhibits' admissibility*.

The Fifth Circuit repeatedly called these unadmitted items "evidence." App. 17, 25. They are not. They are unadmitted non-evidence. The Fifth Circuit used non-evidence to find a disputed and implausible "fact" – that

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[4] The Fifth Circuit never explicitly links knowledge of charges that were "more than the filed rate," App. 17, to knowledge of "unlawful rates," App. 25, but the link is implied.

[5] The Fifth Circuit expressly stated that it did not rely on items the district court excluded from evidence. App. 17 n.6. It never explained why items the district court never ruled on were more reliable than items the district court excluded. All are non-evidence.

policyholders knowingly paid unlawful overcharges – that contradicted the district court's "no evidence" finding.

The Fifth Circuit used this improperly found "fact" to hold that individual issues predominate. Concluding that "RICO fraud cases 'require a showing of detrimental reliance *by the plaintiff*,'" App. 22 (emphasis in original), the Fifth Circuit held that Respondents' defense that policyholders knew about unlawful charges raised individual issues. From this, the Fifth Circuit created, for the first time in any court, a "working presumption" against class certification due to "[t]he pervasive issues of individual reliance that generally exist in RICO fraud actions. . . ." App. 23.

As to the target theory, the Fifth Circuit imported a new "contemporaneousness" standard into RICO. It agreed that "disclosure of the true premiums to a regulator could prevent injury to policyholders," App. 33, but found that this was insufficient to constitute "but for" or legal cause, because Respondents' "concealment of inflated premiums would not result in direct and contemporaneous injury to the policyholder without the additional act of billing." App. 33.

REASONS FOR GRANTING THE WRIT

1. The Court should resolve two chronic splits among the circuits over proximate cause in RICO fraud cases. One split concerns whether RICO fraud plaintiffs must prove "reliance." The Fifth Circuit and four other circuits require reliance, while five other circuits do not. The other split concerns convergence, *i.e.*, whether the person harmed and the person deceived must be the same. The Fifth, Sixth and Eleventh Circuits require convergence. Six other circuits do not. The latter recognize that proximate cause exists when the plaintiff is the intended target of a deception practiced on a third party, especially a regulator charged with protecting the plaintiff. The Fifth Circuit used both the reliance and convergence requirements to decertify the policyholder class. A decision by this Court to eliminate either would require reversal.

A circuit's law on reliance and convergence determines whether RICO fraud class actions exist in that circuit. In

circuits like the Seventh, which reject these requirements, RICO fraud class actions can be maintained and are common. In circuits like the Fifth, which impose them, RICO fraud class actions are essentially forbidden. The decision below adopts a "working presumption" that reliance creates individual issues that prevent courts from certifying RICO fraud class actions. The presumption countermands this Court's statement that "[p]redominance is a test readily met in certain cases alleging . . . fraud." *Amchem Prods., Inc. v. Windsor,* 521 U.S. 591, 625 (1997). The presumption also prevents the class action from serving its "core" function: enabling victims with small claims to obtain relief. *Id.* at 617. This class contains many such claimants. App. 51-52 n.11. The class action is the most potent weapon small purchasers and investors have against fraud. At this point in our nation's history, when the fight against fraud has taken on new urgency, this Court should preserve the class action as an important means of enforcing antifraud laws.

The ban on class actions is especially devastating when insurance frauds cross state boundaries because RICO provides the only foundation for a nationwide response. As state regulators previously told this Court, "[c]ivil RICO is probably the most effective deterrent that presently exists against . . . conspiracies to evade oversight by insurance regulators. . . ." Brief of Amicus Curiae National Association of Insurance Commissioners at *5, *Humana, Inc. v. Forsyth*, 525 U.S. 299 (1999) (No. 97-303) (1998 WL 644642). RICO cannot serve this purpose in those circuits that prohibit RICO class actions.

2. The Court should summarily reverse the Fifth Circuit for denying Wall Street's right to due process. First, by considering non-evidence and giving it determinative weight, the Fifth Circuit converted a process in which only admitted evidence counted into one in which non-evidence mattered more. Respondents demanded an "evidentiary hearing"; the district court ordered an "evidentiary hearing"; the district court "conducted an evidentiary class certification hearing"; and the district court published an opinion that cites only "evidence at the

certification hearing" in support of facts. Then, without warning, the Fifth Circuit used non-evidence to find new facts. This change violated Wall Street's right to notice and is repugnant to due process.

Second, the Fifth Circuit withheld the identity of the pieces of non-evidence it relied on, saying only that the items were in the district court's record. The record contains tens of thousands of pages of non-evidence. No one can know on which items the Fifth Circuit relied or whether they support the "fact" it found. Meaningful appellate review is impossible, in derogation of due process.

Third, the Fifth Circuit abrogated FED. R. EVID. 101, which states "[t]hese rules [of evidence] govern proceedings in the courts of the United States." Class certification decisions are not exempt. By disregarding Rule 101, the Fifth Circuit denied Wall Street notice of the procedures that would apply.

Fourth, the Fifth Circuit violated FED. R. CIV. P. 52(a) by ignoring the district court's express "no evidence" finding and finding a "fact" based on non-evidence. Rule 52(a) states that "[f]indings of fact . . . shall not be set aside unless clearly erroneous." The district court expressly found "no evidence" that policyholders knew about Respondents' scheme. The Fifth Circuit did not declare this finding erroneous. It ignored the finding and usurped the district court's role, using non-evidence to make new findings itself. Because Wall Street never received notice that fact-finding would occur in the Fifth Circuit, it was denied due process.

Plainly, the Fifth Circuit's conduct in this case departs so greatly "from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's supervisory powers. . . ." SUP.CT. R. 10(a). Why did the Fifth Court act so egregiously? Because it disdains class actions. From January, 2000 to February, 2003, the Fifth

Circuit decertified or dismissed 13 plaintiff classes and reversed 0 certification denials.[6]

To defeat class actions, the Fifth Circuit consistently holds that individual issues defeat predominance as a matter of law. *See, e.g.*, *O'Sullivan*, 319 F.2d 744-45. Here, no admitted evidence created individual issues, so the Fifth Circuit mined the record for non-evidence that did. It then found that some policyholders may have knowingly paid unlawful charges, a finding not grounded in evidence. Not even Respondents contended that policyholders had this much knowledge, which explains why the Fifth Circuit never identified the items on which it relied.

I. This Court Should Resolve Two Conflicts Concerning Proximate Cause.

A. Circuits are split over whether reliance by the plaintiff is required in RICO fraud cases.

A RICO plaintiff must prove an injury to business or property that occurred "by reason of" a predicate act. 18 U.S.C. § 1964(c). The predicate act must be a proximate cause of the injury. *Holmes*, 503 U.S. at 268. A central

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[6] *See McManus v. Fleetwood Enter., Inc.*, 320 F.3d 545 (5th Cir. 2003) (decertifying (b)(2) class and finding that certification of (b)(3) class was improper on all theories but one); *O'Sullivan v. Countrywide Home Loans, Inc.*, 319 F.3d 732 (5th Cir. 2003) (decertifying two classes certified by different district courts); *Sandwich Chef of Texas, Inc. v. Reliance Nat. Indem. Ins. Co.*, 319 F.3d 205 (5th Cir. 2003) (decertifying class); *Casas v. Am. Airlines, Inc.*, 304 F.3d 517 (5th Cir. 2002) (same); *Rivera v. Wyeth-Ayerst Labs.*, 283 F.3d 315 (5th Cir. 2002) (dismissing class action); *Stirman v. Exxon Corp.*, 280 F.3d 554 (5th Cir. 2002) (decertifying class); *Smith v. Texaco, Inc.*, 263 F.3d 394 (5th Cir. 2001) (same), *opinion withdrawn, appeal dismissed,* 281 F.3d 477 (5th Cir. 2002); *Berger v. Compaq Computer Corp.*, 257 F.3d 475 (5th Cir. 2001) (same); *Patterson v. Mobil Oil Corp.*, 241 F.3d 417 (5th Cir. 2001) (decertifying class); *Bolin v. Sears, Roebuck & Co.*, 231 F.3d 970 (5th Cir. 2000) (same); *Spence v. Glock, Ges.m.b.H.*, 227 F.3d 308 (5th Cir. 2000) (same); *Washington v. CSC Credit Servs. Inc.*, 199 F.3d 263 (5th Cir. 2000) (same).

element of proximate cause is "a demand for some direct relation between the injury asserted and the injurious conduct alleged." *Id.* In the decade since *Holmes*, the circuits have wrestled with the parameters of proximate cause in civil RICO fraud cases, *i.e.*, those cases predicated upon the federal fraud statutes of mail and wire fraud.

Neither *Holmes* nor any other decision of this Court identifies "reliance" as an element of proximate cause in civil RICO fraud. RICO does not mention reliance. 18 U.S.C. § 1964(c). Nor is reliance an element of the offences of mail or wire fraud. *Neder v. United States*, 527 U.S. 1, 24-25 (1999) ("The common-law requirement[ ] of 'justifiable reliance' [has] no place in the federal fraud statutes.").

Accordingly, five circuits require RICO fraud plaintiffs to prove proximate cause, *not* reliance. *See, e.g., Sys. Mgmt., Inc. v. Loiselle*, 303 F.3d 100, 104 (1st Cir. 2002) ("There is no good reason here to depart from RICO's literal language by importing a reliance requirement into RICO."); *Tabas v. Tabas*, 47 F.3d 1280, 1294 n.18 (3rd Cir. 1995) (*en banc*) ("assertion that the mailings involved must themselves be relied upon by the victim of the fraud in order for a RICO claim to be established is inaccurate."); *United Healthcare Corp. v. Am. Trade Ins. Co.*, 88 F.3d 563, 571 n.5 (8th Cir. 1996) ("[I]t is well settled that such a showing [of detrimental reliance] is not required to prove mail or wire fraud."); *Wilcox v. First Interstate Bank of Or.*, 815 F.2d 522, 531 n.7 (9th Cir. 1987) ("the elements necessary to support damages under civil RICO are different from . . . common law fraud. The difference is that 'justifiable reliance is not an element that need be proven to establish a mail fraud violation.'") (*quoting Armco Indus. Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475, 482 (5th Cir. 1986)).

Five other circuits have created a reliance requirement that has no legal basis. *See, e.g., County of Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1311 (2d Cir. 1990); *Chisolm v. TranSouth Fin. Corp.*, 95 F.3d 331, 337 (4th Cir. 1996); *Summit Props. Inc. v. Hoechst Celanese Corp.*, 214 F.3d 556, 562 (5th Cir. 2000); *Cent. Distribs. of Beer, Inc. v. Conn*, 5 F.3d 181, 184 (6th Cir. 1993); *Johnson*

Enters. of Jacksonville, Inc. v. FPL Group, Inc., 162 F.3d 1290, 1318 (11th Cir. 1998).

B. Circuits are split over whether convergence is required in RICO fraud cases.

The circuits are also split on a second question of causation: Must the person deceived and the person injured by a deception be the same? The circuits that do not require reliance will find proximate cause where a plaintiff was the intended target of the fraud and suffered a direct injury, even though the misrepresentation was to a third party.[7] *See, e.g., Loiselle*, 303 F.3d at 104; *Brokerage Concepts, Inc. v. U.S. Healthcare, Inc.*, 140 F.3d 494, 521 (3d Cir. 1998); *Israel Travel Advisory Serv., Inc. v. Israel Identity Tours, Inc.*, 61 F.3d 1250, 1257 (7th Cir. 1995); *BCCI Holdings (Luxemburg), S.A. v. Khalil*, 214 F.3d 168, 173-74 (D.C. Cir. 2000); *see also United States v. Blumeyer*, 114 F.3d 758, 767-68 (8th Cir. 1997) (expressly rejecting convergence theory and affirming conviction based upon misrepresentations made to insurance regulators that allowed victimization of others). Even two of the circuits that require reliance, the Second and the Fourth Circuits, permit a civil RICO fraud case where a third party, rather than the injured victim, relied on the defendants' fraud. *See, e.g., Commercial Cleaning Servs., L.L.C. v. Colin Serv. Sys., Inc.*, 271 F.3d 374, 384 (2d Cir. 2001) ("a plaintiff has standing where the plaintiff is the direct target of the RICO violation."); *Mid Atlantic Telecom., Inc. v. Long Distance Servs., Inc.*, 18 F.3d 260, 264 (4th Cir. 1994) (defendant's fraud to customers may have proximately injured plaintiff-competitor).

Other circuits require convergence, *i.e.*, that the injured person and the deceived person be the same. *See,*

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[7] Some circuits, for example, allow *X* to bring a RICO fraud case when a defendant deceives *Y* for the purpose of harming *X*, especially when *Y* is a regulator charged with protecting *X*.

e.g., Conn, 5 F.3d at 184 (defendant must make fraudulent misrepresentation to the victim and the victim must rely to state a RICO fraud claim); *Pelletier v. Zweifel*, 921 F.2d 1465, 1499-1500 (11th Cir. 1991) ("the plaintiff must have been a target of the scheme to defraud *and* must have relied to his detriment. . . ."). In this case, the Fifth Circuit joined the "convergence" circuits by establishing a contemporaneous reliance requirement that can be fulfilled only when the person harmed and the person deceived are the same. App. 32-33.

C. The splits over reliance and convergence determine whether RICO fraud cases can be maintained as class actions.

The circuits' splits over reliance and convergence manifest themselves directly in class certification decisions. RICO fraud class actions often proceed in the Seventh Circuit, which requires only proximate cause, but they never proceed in the Fifth and Eleventh Circuits, which require reliance and convergence. This encourages forum shopping.

The Seventh Circuit affirmed certification of a RICO fraud case in *Rosario v. Livaditis*, 963 F.2d 1013 (7th Cir. 1992), a post-*Holmes* case. The Seventh Circuit has clearly rejected convergence. *Israel Travel,* 61 F.3d at 1257. Fittingly, district courts in the Seventh Circuit routinely certify RICO fraud claims under Rule 23(b)(3), often stating that proof of reliance is not required. *See, e.g., In re Synthroid Mktg. Litig.*, 188 F.R.D. 295, (N.D. Ill. 1999) ("[i]ndividual reliance is not an element of a claim under . . . RICO that is predicated on acts of mail and wire fraud[.]"); *Garner v. Healy*, 184 F.R.D. 598, 602 n.4 (N.D. Ill. 1999) (same); *Johnson v. Aronson Furniture Co.*, 1998 WL 641342 at *8 (N.D. Ill. Sept. 11, 1998) (same); *Peterson v. H & R Block Tax Servs., Inc.*, 174 F.R.D. 78, 84 (N.D. Ill. 1997) (same); *Ruiz v. Stewart Assoc., Inc.,* 171 F.R.D. 238, 240-41 (N.D. Ill. 1997) (same); *Balderos v. Ill. Vehicle Premium Fin. Co.*, 1997 WL 627650 at *7 (N.D. Ill. Oct. 2, 1997) (same); *Cannon v. Nationwide Acceptance Corp.*, No. 96 C

1136, 1997 WL 779086, at *7 (N.D. Ill. Dec. 12, 1997) (same); *Arenson v. Whitehall Convalescent & Nursing Home, Inc.*, 164 F.R.D. 659, 666 (N.D. Ill. 1996) (same).[8]

By comparison, the Eleventh Circuit, which requires reliance and convergence, does not allow RICO fraud class actions. *See, e.g., Andrews v. Am. Tel. & Tel. Co.*, 95 F.3d 1014, 1025 (11th Cir. 1996); *Sikes v. Teleline, Inc.*, 281 F.3d 1350, 1364 (11th Cir. 2002) (reliance and causation elements of RICO fraud cannot be resolved on a class-wide basis); *Burstein v. First Penn-Pac. Life Ins. Co.*, 209 F.R.D. 674, 677 (S.D. Fla. 2002) (same); *Gibbs Props. Corp. v. Cigna Corp.*, 196 F.R.D. 430, 440 (M.D. Fla. 2000) ("separate inquiries into reliance make this [RICO fraud case] unmanageable as a class action.").

The Fifth Circuit once resembled the Seventh in rejecting a reliance requirement. *Akin v. Q-L Invs., Inc.*, 959 F.2d 521, 533 (5th Cir. 1992) ("Plaintiffs' problems of proof [of reliance] . . . do not necessarily haunt their claim of mail fraud [as a RICO predicate act] since reliance is not an element of mail fraud.").[9] It then changed course. *See Bolin v. Sears, Roebuck & Co.*, 231 F.3d 970, 978 (5th Cir. 2000) (decertifying class and holding that "a finding of RICO fraud liability requires a showing of reliance by each plaintiff."); *Patterson v. Mobil Oil*, 241 F.3d 417, 419 (5th Cir. 2001) (same). The Fifth Circuit's decisions that incorporate reliance into RICO have occurred only in class actions.[10]

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[8] A few Seventh Circuit district courts hold that reliance is required, but still certify RICO fraud claims where the deception is written. *See, e.g., Rohlfing v. Manor Care, Inc.*, 172 F.R.D. 330, 338 (N.D. Ill. 1997) (requiring reliance, but certifying case on written representations).

[9] *See Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1129-30 (5th Cir. 1988) (upholding RICO mail fraud claim without requiring proof of reliance); *Armco Indus.*, 782 F.2d at 481-82.

[10] In the Fifth Circuit, even a whiff of a reliance issue is a sufficient excuse for decertifying a class. *See, e.g., McManus*, 320 F.3d at 550

(Continued on following page)

D. This case fully presents the conflict over reliance and convergence.

"The rift over reliance stems from the judiciary's failure to abide by *Holmes*."[11] This case is a concrete opportunity for this Court to reinvigorate *Holmes* by resolving the conflicts over reliance and convergence. The district court certified a class on two causal theories: an "invoice" theory in which policyholders were both deceived and harmed, and a "target" theory in which state regulators were deceived. The Fifth Circuit decertified on both theories, claiming that the need for individualized proof of reliance prevents certification on the invoice theory, and effectively eliminating the target theory by imposing a demanding requirement for causation that can be met only when the victim is also the person deceived. By granting this petition, this Court can eliminate the reliance requirement, the convergence requirement, or both, and order reinstatement of the class.

1. The Fifth Circuit has incorrectly replaced factual and proximate cause with reliance, thereby denying relief to many directly injured policyholders.

The reliance requirement narrows the set of eligible plaintiffs significantly. Reliance eliminates class litigation as a tool to enforce RICO. In other instances, splits over reliance generate conflict over the very right of injured persons to bring RICO suits. *Compare, e.g., Sebago v. Beazer E., Inc.*, 18 F. Supp.2d 70, 83 (D. Mass. 1998) (allowing suit by end users who did not rely on misrepresentations), *with Summit*, 214 F.3d at 560 (disallowing

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(decertifying on ground that express warranty cause of action requires "a form of reliance" and "reliance to a certain extent").

[11] Michael Goldsmith & Evan S. Tilton, *Proximate Cause In Civil Racketeering Cases: The Misplaced Role of Victim Reliance*, 59 WASH. & LEE L. REV. 83, 110 (2002).

suit by end users who did not rely). Reliance is "the most obvious way in which fraud can cause harm, but it is not the only way." *Loiselle*, 303 F.3d at 104. Only a fraction of fraud victims rely on misrepresentations personally. Many, especially those protected by regulators, are the direct victims of deceptions practiced on others.

The First Circuit's decision in *Loiselle* is instructive in the proper application of RICO causation. The defendant, Loiselle, obtained a janitorial services contract from a college after promising to pay his employees a statutory minimum wage. He then knowingly paid some employees less. The underpaid employees sued Loiselle under RICO. Loiselle's lies *to the college* were alleged predicate acts of mail fraud. On appeal, Loiselle conceded that he deceived the college and that his conduct was a "but for" cause of his employees' injuries. *Id.* at 103. He argued that he was not liable under RICO because no evidence showed that he deceived the employees or that they relied on his lies to the college. *Id.* at 103.

The First Circuit, after considering the conflict among the circuits, refused to read a reliance requirement into RICO, noting that "a reasonably predictable consequence" of Loiselle's deceit of the college was "to enable him to continue to underpay his workers." *Id.* at 104. The injured employees could sue because the First Circuit required factual and proximate cause, not reliance. The decision is consistent with this Court's decision in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495 (1985), which rejected the circuit courts' attempts to limit RICO's scope by importing the amorphous requirement of a "racketeering injury," holding that "[t]here is no room in the statutory language for an additional . . . requirement." The First Circuit in *Loiselle* likewise reasoned that "[t]here is no good reason

here to depart from RICO's literal language by importing a reliance requirement[.]" *Id.* at 104.[12]

The Fifth Circuit's reason for adopting reliance is that "a general requirement of reliance by the plaintiff is a commonsense liability limitation." *Summit*, 214 F.3d 562. Whether it is common sense or not, a reliance limitation on RICO must come from Congress, not the judiciary. *See Sedima*, 473 U.S. at 499-500.

Loiselle and the Fifth Circuit's decision cannot be reconciled because, in the Fifth Circuit, reliance has replaced proximate cause. This decision greatly handicaps fraud victims. Respondents' fraud on state regulators was a substantial cause of the policyholders' injuries. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON TORTS § 41, at 267 (5th ed. 1984) ("[t]he defendant's conduct is a cause of the event if it was a material element and a substantial factor in bringing it about."). The Fifth Circuit noted that regulators would have protected policyholders from overcharges had Respondents not deceived them. App. 33. Yet, the reliance requirement prevents Option V policyholders from using Respondents' lies to regulators to establish proximate cause under RICO. Because policyholders did not know about these lies, they could not have relied on them, even though they did rely on regulators for protection. There is no reason to impose a reliance requirement that defines factual causation more narrowly. There is no such provision in RICO or the federal fraud statutes. Indeed, it can only prevent RICO from protecting persons who are "injured in their business or property by reason of" racketeering. 18 U.S.C. § 1964(c).

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[12] The First Circuit ultimately reversed the judgment against Loiselle because his conduct did not demonstrate a pattern of racketeering. *Loiselle*, 303 F.3d at 105.

2. The Fifth Circuit misapplied *Holmes*'s direct injury requirement.

When certifying the class on the target theory, the district court expressly relied on this Court's decision in *Holmes*, finding that Respondents' scheme to collect overcharges through misrepresentations made to insurance regulators caused a "direct injury" to Wall Street and other policyholders. App. 100, 63-64. It found the same direct injury arose from Wall Street's invoice theory. App. 66. Only policyholders lost money and Respondents' racketeering was the sole cause. Policyholders are the only ones who can enforce RICO as private attorneys general.

Loiselle is consistent with the core holding of *Holmes*: a person directly injured by racketeering can presumptively sue under RICO. *See Holmes*, 503 U.S. at 269. A "directly injured" plaintiff is one whose injury is not derivative of another. *Holmes*, 503 U.S. at 274. The injuries of Loiselle's employees were not derivative; they were direct. Here, policyholders' injuries were not derivative; they were directly caused by Respondents' scheme to overcharge. Policyholders were the intended victims and the only victims that suffered financial loss. *Holmes* entitles them to sue. The Fifth Circuit's conclusion otherwise is inconsistent with *Holmes*.

3. The Fifth Circuit's adoption of a convergence requirement is incorrect.

Holmes explained that a plaintiff may establish proximate cause if it was directly injured by a defendant's fraud on a third person. It recognized that the customers of the insolvent broker-dealers might recover under RICO fraud for losses stemming from deceit upon regulators, despite the fact that those customers did not "rely" on a misrepresentation. *Holmes*, 503 U.S. at 272 n.19. This Court reasoned that but for the deceit, regulators would have shut down the broker-dealers and the customers would have been injured "to a lesser extent," thus demonstrating proximate cause. *Id.*

The district court respected *Holmes* when it certified a class on Wall Street's target theory. "Reliance upon a fraudulent representation or omission by a third person – here, regulators – is sufficient to state a RICO claim if the plaintiff is injured as a result." App. 61. The district court noted that "[o]ther circuits have accepted the target analysis, particularly where the fraud is perpetuated upon a regulator for the purpose of defrauding a protected class."[13] App. 61. Respondents' conspiracy to defraud state regulators injured all policyholders the same way. App. 63-63.

When decertifying the target theory class, the Fifth Circuit deviated from both *Holmes* and its own decision in *Summit*, which explicitly recognized that a plaintiff can establish proximate cause under *Holmes* by showing that it was "the target of a fraud." *Summit*, 214 F.3d at 561. Here, the target theory clearly applied to policyholders, all of whom were targets of Respondents' scheme to use NCCI to deceive state regulators. The Fifth Circuit acknowledged that "disclosure of the true premiums to a regulator could [have] *prevent[ed]* injury to policyholders by prompting the regulator to interdict the carrier's attempt to bill at an inflated rate." App. 33 (emphasis in original).

The Fifth Circuit adopted a convergence requirement when it said RICO plaintiffs must "demonstrate injury as a direct and *contemporaneous* result of fraud committed against a third party. . . ." App. 31 (emphasis added). Prior opinions allowed the plaintiff to sue when it was the target of a deception practiced on another. *Proctor & Gamble v. Amway Corp.*, 242 F.3d 539 (5th Cir. 2001), *cert. denied*, 534 U.S. 945 (2001) (allowing plaintiff to sue under RICO when defendant lied to plaintiff's customers, who then boycotted plaintiff's business). There, Amway's deception and P&G's harm were separated by time and many intervening acts. Yet, here, the Fifth Circuit ruled that deception

[13] In *Holmes*, 503 U.S. at 273 n.19, this Court cited *County of Suffolk*, 907 F.2d at 1312, for the same proposition.

and harm must occur contemporaneously.[14] It then used the act of billing – the very act needed to complete Respondents' fraud – to show that the deception and the harm were separated. App. 33; *but cf. Brokerage Concepts*, 140 F.3d at 521 (recognizing in target theory context that chain of causation cannot be broken by an act that is itself a predicate act for RICO liability).

This Court has never imposed a "contemporaneousness" requirement. The word "contemporaneous" does not appear in *Holmes*. The requirement has no basis in law. *See* 1 AM. JUR. 2d, *Actions* § 57 (1994) ("The wrong need not be contemporaneous with the resulting damage."). The decision below invented the requirement. The risk to businesses that rely on regulators for protection is clear. All rate-regulated industries – telephone, gas, power, water, insurance, transportation, etc. – deal with business customers and regulators separately. The "contemporaneousness" requirement allows all these industries to defraud regulators and overcharge customers without fear of RICO. It protects an entire genre of business fraud from redress by perversely asserting that bills used to collect illegal charges break the chain of causation.

A target of a RICO scheme *never* suffers injury immediately from fraud on a third party; further acts, often many acts by many participants, are always required. In *Loiselle*, for example, the underpaid employees' injuries did not occur as a "direct and contemporaneous" result of Loiselle's deceit of the college. Workers had to accept employment at substandard rates after the lie was told. Likewise, after

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[14] The Fifth Circuit held in this case that the target theory is a "narrow exception." App. 31. That interpretation kills the target theory and embraces convergence, because the target of a RICO scheme never suffers injury immediately by fraud perpetrated upon a third party. The Fifth Circuit retains the "lure the customer" theory only. *See, e.g., Richard v. Hoechst Celanese Chemical Group, Inc.*, 208 F.R.D. 575, 587 (E.D. Tex. 2002); *Reuther v. Smith*, 2003 WL 1955167, at *6, 8 n.8 (E.D. La. Apr. 22, 2003).

Respondents lied to regulators, each policyholder had to pay its invoice. In both instances, the plaintiffs lost money because the racketeer deceived another.

4. The Fifth Circuit incorrectly found that Wall Street's invoice theory could be defeated by a policyholder's knowledge of an "unfiled rate."

The Fifth Circuit incorrectly found that a policyholder's payment of an invoice with knowledge of an unfiled rate could defeat reliance and target theories. App. 17, 25. Even plaintiffs with some culpability have standing to pursue RICO claims. *See, e.g. Roma Constr. Co. v. aRusso*, 96 F.3d 566, 574-75 (1996) (fact that plaintiff participated in bribery did not prevent it from alleging RICO claim). RICO's public policy of "root[ing] out public corruption" would be undermined if a plaintiff's limited understanding of the defendants' scheme defeated its RICO claims. *See Bieter Comp. v. Blomquist*, 848 F. Supp. 1446, 1449-50 (D. Minn. 1994) (discussing *in pari declicto* as applied to RICO) (citing *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985). This Court has emphasized "the inappropriateness of invoking broad common-law barriers to relief where a private suit serves important public purposes." *Perma Life Mufflers, Inc. v. Int'l Parts Corp.*, 392 U.S. 134, 138 (1968), *rev'd on other grounds, Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 765-66, 777 (1984) ("It was for this reason that we held in *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211 (1951), that a plaintiff in an antitrust suit could not be barred from recovery by proof that he had engaged in an unrelated conspiracy to commit some other antitrust violation.").

The district court correctly addressed Respondents' arguments concerning pre-policy negotiations when it considered *in pari delicto*. It found "[n]o evidence of any class member's involvement in the alleged scheme was presented to the Court in the certification hearing." App. 76. To allow a pre-policy agreement to pay an unfiled rate

to defeat a RICO plaintiff's claim would be to improperly allow a common law defense to prevent the enforcement of RICO. *See, e.g., Perma Life*, 392 U.S. at 138-39.

Here, the fraud did not occur at sale. Policyholders and Respondents may agree to deviate from filed rates *with regulators' approval*. Since Respondents never obtained approvals of regulators, however, their charges were unlawful *when billed*. The fraud occurred when Respondents sent inflated invoices *without approval*. App. 67 (noting that the fraud in the invoice was Respondents' failure to disclose that they "had not made the necessary filings to allow the deviant charges" and that "[a]bsent such filings, [Respondents] could not lawfully charge the amount invoiced."). A policyholder "cannot be reasonably expected to maintain such expertise in the intricacies of state workers' compensation regulatory requirements in each of the many states in which it does business." *Wal-Mart Stores, Inc. v. Crist*, 855 F.2d 1326, 1331-32 (8th Cir. 1988). A policyholder has neither the obligation nor the resources to ascertain "whether the insurer had properly applied filed rate deviations, if any, in each relevant state." *Id.* at 1332. Policyholders' payments were circumstantial evidence that they thought the bills were lawful.[15] App. 68-71. There is no evidence of any knowledge of illegality, and certainly none that bars any policyholder's RICO claims.

5. The Fifth Circuit's "working presumption" against RICO class actions contradicts *Amchem*.

By definition, RICO fraud claims "focus[ ] on the defendant's conduct in devising or intending to devise a

[15] "The act of making such payments would adequately demonstrate detrimental reliance. The Court finds that such acts would show that each plaintiff was convinced that the sale had been legal and legitimate." *Chisolm v. TranSouth Fin. Corp.*, 184 F.R.D. 556, 563 (E.D. Va. 1999).

scheme to defraud, not the individual experiences of each defrauded person." *Peterson*, 174 F.R.D. at 84 (quoting *United States v. Biesiadecki*, 933 F.2d 539, 544 (7th Cir.1991)); *see also Heastie v. Cmty. Bank of Greater Peoria*, 125 F.R.D. 669, 674-75 (N.D. Ill. 1989) (certifying class, holding a scheme to defraud violates RICO regardless of the victim's characteristics).

In contrast, by imposing a reliance requirement, the Fifth Circuit looks only at the experiences of the plaintiffs, thus ignoring the more important scheme. The Fifth Circuit employs a "working presumption" that the need to prove reliance individually undermines predominance, preventing certification of RICO class actions. The presumption contradicts this Court's plain statement that "[p]redominance is a test readily met in certain cases alleging consumer or securities fraud. . . ." *Amchem*, 521 U.S. at 625. When saying this, the Court spoke of cases like this one, where "a fraud [is] perpetrated on numerous persons by the use of similar misrepresentations." Adv. Comm. Notes, 28 U.S.C. App., p. 697 (cited in *Amchem*, 521 U.S. at 625). Here, all policyholders received identical misrepresentations in writing – invoices containing inflated charges. In the Seventh Circuit, this case would be considered a "'classic case for treatment as a class action'" because the policyholders' "claims . . . are premised on written misrepresentations contained in standard documents furnished to every class member." *Peterson*, 174 F.R.D. at 83 (citation omitted).

The Fifth Circuit also contradicted *Amchem* by giving no weight to the district court's finding that many policyholders' claims are too small to warrant the cost of conventional litigation. App. 51-52 n.11. According to *Amchem*, 521 U.S. at 617, "[t]he policy *at the very core of the class action mechanism* is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights." The Fifth Circuit's presumption prevents the class action from serving its core function. District courts cannot even weigh the difficulty of handling a few victims with knowledge issues individually against the advantage of handling the vast majority of claims *en masse*. Otherwise, the Fifth

Circuit would have remanded instead of decertifying. The Fifth Circuit never showed that even one policyholder knew Respondents' charges were unlawful. Its view must be that reliance undermines predominance when even one class member might theoretically have to be handled individually.

"The object of civil RICO is [ ] not merely to compensate victims but to turn them into prosecutors, 'private attorneys general,' dedicated to eliminating racketeering activity." *Rotella v. Wood*, 528 U.S. 549, 557 (2000). The Fifth Circuit's decision wrongly uses the reliance and convergence requirements to deter victims from attacking carefully orchestrated business frauds.

II. This Court Should Summarily Reverse To Cure Several Patent Due Process Violations.

Due process prevents arbitrary behavior by requiring judges to follow established rules and procedures. The district court followed the rules. It ordered an "evidentiary hearing," it applied the rules of evidence at the hearing, and it cited only evidence admitted at the hearing when finding facts.

The Fifth Circuit did not follow the rules. It ignored the admitted evidence. It also ignored three findings made by the district court: (1) that evidence introduced at the certification hearing showed that policyholders' reliance on Respondents' inflated bills was a common issue; (2) that additional evidence showed that Respondents' conspiracy injured all policyholders the same way; and (3) that no evidence showed that policyholders knowingly paid unlawful rates. In lieu of all this, the Fifth Circuit relied on non-evidence and found a new "fact." By doing so, it denied Wall Street due process of law. U.S. CONST. amend. V.

A. Courts must base facts on admitted evidence, not non-evidence.

Due process requires every fact to have supporting admitted evidence. *Chicago Junction Case*, 264 U.S. 258, 265 (1924); *Interstate Commerce Comm'n v. Louisville & Nashville R.R. Co.*, 227 U.S. 88, 91 (1913); *Crowell v. Benson*, 285 U.S. 22, 48 (1932).

Due process also requires courts to ignore non-evidence, including items that a party files but fails to introduce. *Morgan v. United States*, 298 U.S. 468, 480 (1936) ("Nothing can be treated as evidence which is not introduced as such. . . . [O]ne who decides shall be bound in good conscience to consider the evidence, *[and] to be guided by that alone. . . .*"); *Crowell*, 285 U.S. at 48 ("Facts conceivably known . . . , but not put in evidence so as to permit scrutiny and contest" cannot support an order.).

The Fifth Circuit found "that plaintiffs were aware that carriers were charging them more than the filed rates." App. 17. It cited ***no*** admitted evidence for this finding, and it expressly relied on unidentified non-evidence. For both reasons, the Fifth Circuit violated "the fundamental concept of procedural due process that a party to litigation is entitled to have the evidence relied on by his opponent presented at the hearing[.]" *In re Aughenbaugh*, 125 F.2d 887, 888 (3d Cir. 1942). Because only this finding supports the Fifth Circuit's order, this Court should summarily reverse.

B. A court must notify parties before considering non-evidence, and it must specifically indicate the items it will consider.

At Respondents' insistence, the district court ordered the parties to present their cases on class certification at an "evidentiary hearing," R38:5:16-17. The order put the parties on notice that the Federal Rules of Evidence would

"govern [the] proceedings. . . . " FED. R. EVID. 101.[16] Nothing changed this expectation thereafter. Both sides prepared and made evidentiary presentations. The district court consistently followed the rules. It expressed no intention of relying on anything but admitted evidence, and there is no indication that it did. Its order certifying the class, which specifically states that it "conducted an ***evidentiary*** class certification hearing from January 8 through January 12, 2001," App. 37, cites ***only*** admitted evidence.

Having ordered an evidentiary hearing, the district court had no power to disregard the rules. *Louisville & Nashville*, 227 U.S. at 91 (the authority to "disregard all rules of evidence, and capriciously make findings by administrative fiat . . . is inconsistent with rational justice, and comes under the Constitution's condemnation of all arbitrary exercise of power."). Only a clear warning of intent to consider specific items of non-evidence followed by the parties' acquiescence could have given the district court this power. *United States v. Abilene & S. Ry. Co.*, 265 U.S. 274, 289 (1924) ("The requirement that in an adversary proceeding specific reference be made, is essential to the preservation of the substantial rights of the parties.").

The district court gave no such warning. It adhered strictly to the Rules of Evidence. The Fifth Circuit did not. It expressly based its crucial "fact" on non-evidence. To justify this gambit, the Fifth Circuit had to show that the district court told the parties it would consider the very same items the Fifth Circuit relied on. It did not do this. It did not even say on which items it relied, much less show that the district court told the parties those specific items would be considered. The Fifth Circuit thus denied Wall Street due process of law.

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[16] FED. R. EVID. 1101 exempts some proceedings from the scope of FED. R. EVID. 101, but not certification hearings.

The failure to identify materials specifically compounds the error by making appellate review impossible. The district court's record contains tens of thousands of pages of unadmitted filings and proffers. No one knows on which items the Fifth Circuit relied. Consequently, no one can say whether non-evidence supports the Fifth Circuit's crucial "fact." The denial of meaningful appellate review violates due process. *Garner v. Louisiana*, 368 U.S. 157, 173-174 (1961); *Ohio Bell Tel. Co. v. Public Util. Comm'n*, 301 U.S. 292, 302 (1937).

In an attempt to rationalize its holding, the Fifth Circuit quoted four statements by the district court that, in its judgment, expressed the intention of considering non-evidence. App. 17-18. No statement comes even close to meeting the due process standard. Two of the statements were made *after* the evidentiary portion of the certification hearing closed. App. 17-18. These statements could not possibly have provided advance notice of anything. Of the two remaining statements, one told the parties they "[could] get whatever [they] want[ed] into the record." App. 17-18. The other excluded an expert report from evidence without saying the district court would rely on it: "Let's leave it not in evidence, but it's part of the record in this case." App. 18. Even read charitably, these statements do not justify the Fifth Circuit's action, for the Fifth Circuit never said it relied on the same items the district court had before it when making these remarks.

If the district court had intended to rely on prehearing filings and proffers, it could have said so simply and in plain English. It did not. Instead, it conducted a week long evidentiary hearing, during which it made some innocuous statements that the Fifth Circuit distorted and used for its own purposes. By failing to consider whether the statements had plausible meanings consistent with due process, the Fifth Circuit again violated the law. Trial judges are presumed to know the law and to apply it constitutionally in making their decisions. *Lambrix v. Singletary*, 520 U.S. 518, 532 n.4 (1997) (citing *Walton v. Arizona*, 497 U.S. 639, 653 (1990), *rev'd on other grounds*, *Ring v. Arizona*, 536 U.S. 584, 609 (2002)).

C. The Fifth Circuit denied Wall Street due process by abrogating FED R. EVID. 101.

FED. R. EVID. 101 states that "[t]hese rules [of evidence] govern proceedings in the courts of the United States." Nothing exempts class certification hearings from this rule. The Fifth Circuit abrogated Rule 101. By doing so, it acted arbitrarily and denied Wall Street due process of law. *S. Ry. Co. v. Virginia,* 290 U.S. 190, 195 (1933) (the authority to "disregard all rules of evidence, and capriciously make findings by administrative fiat . . . is inconsistent with rational justice, and comes under the Constitution's condemnation of all arbitrary exercise of power".).

D. The Fifth Circuit denied Wall Street due process by violating FED. R. CIV. P. 52(a).

Rule 52(a) provides a district court's findings of fact "shall not be set aside unless clearly erroneous." The Fifth Circuit denied Wall Street due process by violating this rule repeatedly.

First, the Fifth Circuit determined two facts, neither of which the district court found: (1) policyholders knowingly paid unlawful rates, and (2) the number of policyholders who did so is large enough to defeat predominance. By finding these facts, the Fifth Circuit "violate[d] [its] function, which is to review, rather than to make, findings of fact." *Duffie v. Deere & Co.*, 111 F.3d 70, 74 (8th Cir. 1997). "Fact-finding by [an] appellate court is simply not permitted." *Atlantic Thermoplastics Co. v. Faytex Corp.*, 5 F.3d 1477, 1479 (Fed. Cir. 1993) (citing *Anderson v. City of Bessemer*, 470 U.S. 564, 573 (1985). Long ago, the Fifth Circuit itself observed that it is "not a trier of facts, and does not substitute its own judgment for that of the trial court." *See C. B. Pennington v. Colonial Pipeline Co.*, 387 F.2d 903, 905 (5th Cir. 1968). This Court should remind the Fifth Circuit of its limited role. Because the Fifth Circuit "overstep[ped] the bounds of its duty under Rule 52(a) [when] it under[took] to duplicate the role of the lower court," *Anderson*, 470 U.S. at 573, this Court should reverse.

Second, the Fifth Circuit wrongly ignored the district court's factual findings that (1) "no evidence" showed that policyholders knowingly paid unlawful rates or otherwise participated in Respondents' scheme, and (2) common factual issues predominated. The Fifth Circuit could have declared these factual findings "clearly erroneous," FED. R. CIV. P. 52(a), but it did not. The Fifth Circuit's decision to reverse thus rests upon facts that contradict those found by the district court and that bind the Fifth Circuit, which left them intact. The violation constitutes a due process denial and warrants summary reversal by this Court.

CONCLUSION

The Court should summarily reverse the Fifth Circuit's judgment, or, in the alterative, grant the petition for a writ of certiorari and order plenary briefing and argument.

Respectfully submitted,

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May 28, 2003

APPENDIX

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 01-20924

SANDWICH CHEF OF TEXAS, INC.,
doing business as Wall Street Deli, Individually
and for Others Similarly Situated,

Plaintiff-Appellee,

versus

RELIANCE NATIONAL INDEMNITY INSURANCE COMPANY, formerly known as Planet Insurance Company; RELIANCE INSURANCE COMPANY; RELIANCE LLOYDS; RELIANCE NATIONAL INSURANCE CO.; UNITED PACIFIC INSURANCE CO.; HOME INSURANCE COMPANY, formerly known as City Insurance Co., formerly known as Home Indemnity Company, formerly known as Home Insurance Company, formerly known as Home Insurance Company of Indiana; LIBERTY MUTUAL INSURANCE COMPANY; LIBERTY MUTUAL FIRE INSURANCE COMPANY; LIBERTY INSURANCE CORPORATION; AMERICAN & FOREIGN INSURANCE COMPANY; GLOBE INDEMNITY CO.; ROYAL INDEMNITY CO.; ROYAL INSURANCE COMPANY OF AMERICA; SAFEGUARD INSURANCE CO.; BITUMINOUS CASUALTY CORPORATION; BITUMINOUS FIRE AND MARINE INSURANCE CO.; GREAT WEST CASUALTY INSURANCE CO.; INTERNATIONAL BUSINESS & MERCANTILE REASSURANCE CO.; OLD REPUBLIC INSURANCE COMPANY; NORTH RIVER INSURANCE CO.; INTERNATIONAL INSURANCE COMPANY; WESTCHESTER FIRE INSURANCE COMPANY; UNITED STATES FIRE INSURANCE COMPANY;

UNITED STATES FIDELITY AND GUARANTY COMPANY; FIDELITY & GUARANTY INSURANCE UNDERWRITERS INC.; INDUSTRIAL INDEMNITY; CHUBB INDEMNITY INSURANCE CO.; CHUBB LLOYDS INSURANCE CO. OF TEXAS; FEDERAL INSURANCE COMPANY; GREAT NORTHERN INSURANCE CO.; NORTHWESTERN PACIFIC INDEMNITY CO.; PACIFIC INDEMNITY COMPANY; SUN INSURANCE OFFICE OF AMERICA INC.; TEXAS PACIFIC INDEMNITY CO.; VIGILANT INSURANCE CO.; HIGHLANDS INSURANCE COMPANY; HIGHLANDS UNDERWRITERS INSURANCE CO.; HIGHLANDS CASUALTY CO.; ABERDEEN INSURANCE CO.; BANKERS STANDARD INSURANCE CO.; CENTURY INDEMNITY CO.; INDEMNITY INSURANCE COMPANY OF NORTH AMERICA; INSURANCE COMPANY OF NORTH AMERICA; PACIFIC EMPLOYERS INSURANCE COMPANY; ATLANTIC INSURANCE CO.; AUTOMOBILE INSURANCE COMPANY OF HARTFORD, CONNECTICUT; CHARTER OAK FIRE INSURANCE COMPANY; FARMINGTON CASUALTY CO.; GULF GROUP LLOYDS; GULF INSURANCE CO.; NIPPON FIRE/MARINE INSURANCE CO. LTD., U.S. Branch; PHOENIX INSURANCE COMPANY; SELECT INSURANCE CO.; STANDARD FIRE INSURANCE CO.; TRAVELERS CASUALTY & SURETY CO., formerly known as Aetna Casualty & Surety Co.; TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA, formerly known as Aetna Casualty and Surety Company of America; TRAVELERS CASUALTY & SURETY COMPANY OF ILLINOIS, formerly known as Aetna Casualty & Surety Company of Illinois; TRAVELERS INDEMNITY COMPANY; TRAVELERS INDEMNITY COMPANY OF AMERICA; TRAVELERS INDEMNITY COMPANY OF CONNECTICUT, THE, formerly known as Travelers Indemnity Company of Rhode Island; TRAVELERS INDEMNITY CO. OF ILLINOIS;

TRAVELERS INSURANCE COMPANY; ARGONAUT INSURANCE COMPANY; ARGONAUT MIDWEST INSURANCE COMPANY; ARGONAUT SOUTHWEST INSURANCE COMPANY; AMERICAN HOME ASSURANCE COMPANY; BIRMINGHAM FIRE INSURANCE COMPANY OF PENNSYLVANIA; COMMERCE AND INDUSTRY INSURANCE CO.; GRANITE STATE INSURANCE COMPANY; ILLINOIS NATIONAL INSURANCE COMPANY; THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA; NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA; NEW HAMPSHIRE INSURANCE COMPANY; AMERICAN MANUFACTURING MUTUAL INSURANCE CO.; AMERICAN MOTORISTS INSURANCE COMPANY; AMERICAN PROTECTION INSURANCE CO.; LUMBERMENS MUTUAL CASUALTY COMPANY; EMCASCO INSURANCE CO.; EMPLOYERS MUTUAL CASUALTY COMPANY; FARMLAND MUTUAL INSURANCE CO.; NATIONWIDE AGRIBUSINESS INSURANCE CO.; NATIONWIDE INDEMNITY INSURANCE CO.; NATIONWIDE MUTUAL FIRE INSURANCE CO.; NATIONWIDE MUTUAL INSURANCE COMPANY; NATIONWIDE PROPERTY AND CASUALTY INSURANCE CO.; SCOTTSDALE INDEMNITY CO.; MIDDLESEX INSURANCE CO.; SENTRY INSURANCE, A Mutual Company; EMPLOYERS INSURANCE OF WAUSAU, A Mutual Company; WAUSAU BUSINESS INSURANCE CO.; WAUSAU UNDERWRITERS INSURANCE COMPANY; AGRICULTURAL INSURANCE CO.; AMERICAN ALLIANCE INSURANCE COMPANY; AMERICAN NATIONAL FIRE INSURANCE COMPANY; GREAT AMERICAN INSURANCE CO.; MID-CONTINENT CASUALTY COMPANY; AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA; CONTINENTAL CASUALTY COMPANY; NATIONAL FIRE INSURANCE COMPANY OF HARTFORD; TRANSCONTINENTAL INSURANCE COMPANY;

TRANSPORTATION INSURANCE COMPANY; VALLEY FORGE INSURANCE COMPANY; BOSTON OLD COLONY INSURANCE COMPANY; CASUALTY INSURANCE COMPANY OF TEXAS; COMMERCIAL INSURANCE COMPANY OF NEWARK, NEW JERSEY; THE CONTINENTAL INSURANCE COMPANY; THE FIDELITY AND CASUALTY INSURANCE COMPANY NEW YORK; FIREMEN'S INSURANCE COMPANY OF NEWARK, NEW JERSEY; GLENS FALLS INSURANCE COMPANY; KANSAS CITY FIRE & MARINE INSURANCE CO.; NIAGARA FIRE INSURANCE CO.; AMERICAN GUARANTEE AND LIABILITY INSURANCE COMPANY; ZURICH INSURANCE COMPANY; REPUBLIC-FRANKLIN INSURANCE CO.; UTICA MUTUAL INSURANCE CO.; UTICA NATIONAL INSURANCE COMPANY OF TEXAS; FAIRMONT INSURANCE CO.; TIG INSURANCE COMPANY OF TEXAS, formerly known as Transamerican Insurance Company of Texas; TIG PREMIER INSURANCE CO., formerly known as Transamerica Premier Insurance Company; ASSURANCE COMPANY OF AMERICA; MARYLAND CASUALTY CO.; MARYLAND INSURANCE CO., formerly known as American General Fire and Casualty Company; NORTHERN INSURANCE COMPANY OF NEW YORK; VALIANT INSURANCE CO.; AMERICAN AUTOMOBILE INSURANCE CO.; AMERICAN INS. CO.; ASSOCIATED INDEMNITY CORP.; FIREMAN'S FUND INSURANCE COMPANY; FIREMAN'S FUND INSURANCE COMPANY OF TEXAS; FIREMAN'S FUND INSURANCE COMPANY OF WISCONSIN; NATIONAL SURETY CORP.; THE CONNECTICUT INDEMNITY COMPANY; FIRE & CASUALTY INSURANCE COMPANY OF CONNECTICUT; SECURITY INSURANCE COMPANY OF HARTFORD; ACE FIRE UNDERWRITERS INSURANCE COMPANY, formerly known as Cigna Fire Underwriters Insurance Company; ACE AMERICAN INSURANCE COMPANY, formerly known as CIGNA

Insurance Company; ACE PROPERTY AND CASUALTY INSURANCE COMPANY, formerly known as CIGNA Property & Casualty Insurance Co.; TIG AMERICAN SPECIALTY INSURANCE CO., formerly known as Chilton Insurance Co.; TIG INSURANCE CO., formerly known as Transamerica Insurance Company; ACE INSURANCE COMPANY OF TEXAS, formerly known as Cigna Insurance Company of Texas; and AMERICAN ZURICH INSURANCE COMPANY,

Defendants-Appellants.

Appeal from the United States District Court
for the Southern District of Texas

(Filed Jan. 21, 2003)

Before SMITH and BENAVIDES, Circuit Judges, and FITZWATER, District Judge.*

FITZWATER, District Judge:

Fraud actions that require proof of individual reliance cannot be certified as Fed. R. Civ. P. 23(b)(3) class actions because individual, rather than common, issues will predominate. The district court certified a nationwide Rule 23(b)(3) class in this RICO[1] fraud action based on alleged overcharging of workers' compensation insurance premiums. It did so by eliminating, on substantive grounds,

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* District Judge of the Northern District of Texas, sitting by designation.

Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968.

plaintiff-specific issues of reliance and causation. We hold that the district court erred as a matter of law in doing so and thus abused its discretion in certifying this case as a class action, and we reverse.

I

A

Plaintiff Sandwich Chef of Texas, Inc., d/b/a Wall Street Deli ("Wall Street"),[2] a company that operates delicatessens in several states, brought this putative class action individually and on behalf of others similarly situated. Wall Street contends that defendants – 141 casualty insurance companies – are liable under RICO for committing mail and wire fraud, in violation of 18 U.S.C. § 1962(c)-(d), by charging excessive premiums on retrospectively-rated workers' compensation insurance policies during a 14-year period. Wall Street alleges that defendants corrupted the National Council on Compensation Insurance, Inc. ("NCCI") and used it as a racketeering enterprise to defraud policyholders and state regulators. It maintains that defendants charged excessive premiums to thousands of employers in 44 states and the District of Columbia. Wall Street seeks damages caused by allegedly false filings that defendants and NCCI made with regulators (fraud-on-the-regulator theory) and by inflated invoices sent to policyholders (invoice theory).

Premiums for retrospectively-rated workers' compensation insurance are based on expense factors and loss

[2] Wall Street states in its brief that it is now known as Wall Street Deli, Inc.

experience calculated as of the end of the policy period. Policyholders pay an initial premium, subject to a negotiated minimum and maximum range, and receive refunds or credits or pay additional premiums based on losses.

Most employers purchase workers' compensation coverage in the voluntary market. Those who cannot may obtain insurance through legislatively-established involuntary markets, sometimes called "residual markets," "assigned risk markets," or "assigned risk pools." Some states require workers' compensation insurance carriers to reinsure that state's "residual markets," which often results in additional costs to them when operating deficits occur. When residual market assessments dramatically increased, insurers responded by factoring residual market expenses in the price of their voluntary market insurance. Insurance program documents identified these expenses as "residual market charges" (also known as "residual market loads" or "RMLs").

Option V is a rating plan for retrospectively rated workers' compensation insurance policies. NCCI's WC 00 05 endorsement is the approved form in all 45 pertinent jurisdictions for Option V pricing. States set rates for workers' compensation insurance and require that insurers use only approved rates, rating plans, and policy forms. Insurers who sell Option V policies cannot deviate from these rates without regulatory approval. Wall Street purchased four workers' compensation insurance policies from defendant Reliance Insurance Company ("Reliance")[3]

[3] During the pendency of this appeal, five defendants, including Reliance, which is currently in liquidation, moved to sever and stay their appeals. A panel of this court granted the motion. The motion

(Continued on following page)

during the years 1991 to 1994. Each policy was made subject to retrospective rating by a WC 00 05 endorsement.

Wall Street maintains that insurers sought to pass on RML expenses to their Option V policyholders in the voluntary market, contrary to the terms of the approved rating plan. Defendants instructed NCCI to ask state regulators to amend the Option V rating plan to allow them to pass through their RMLs as an element of the tax multiplier. The tax multiplier is a component of the premium that includes taxes and other assessments that carriers pay. Defendants also began including unfiled and unapproved RML surcharges in tax multipliers for Option V coverage. All defendants overcharged, and they prevented competition through collusion, such as by sharing information about RML charges.

Wall Street also alleges that defendants used NCCI to deceive state regulators. NCCI filed R-1244, in which it requested that regulators authorize a residual market subsidy to be added to the Option V tax multiplier. R-1244 falsely represented that defendants were not presently including RMLs in their rates and intended only to pass through part of the residual market burden to policyholders. Some regulators accepted R-1244; others granted only part of the request or denied it. Defendants nevertheless passed through their full RML expenses. They used NCCI to make other Option V tax multiplier filings after R-1244,

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panel denied without prejudice to reconsideration by this panel defendants' alternative motion to sever and remand the appeal for immediate dismissal. Because we are reversing the class certification order, we need not reconsider the motion panel's order.

which falsely reflected only partial RML subsidies rather than defendants' actual practice of charging full RML expense.

Wall Street avers that regulators required NCCI to review defendants' Option V applications for compliance with lawful rates and to approve only applications that contained authorized rates. Defendants' applications falsely represented that they were charging approved rates for Option V coverage. In turn, state regulators received NCCI-approved applications that concealed defendants' overcharges. NCCI knew of these overcharges but never disclosed them to the regulators. Defendants routinely provided unapproved forms, rating plans, and rates to policyholders that they did not give regulators. In these forms, defendants characterized their unapproved charges as state assessments or taxes. Defendants also failed to disclose their unlawful RML charges in financial statements filed with regulators.

Defendants have a different view of the pertinent facts. They assert that when Wall Street requested that Reliance make a proposal for commercial insurance, Wall Street offered to pay the RML expenses that are the subject of its complaint. Wall Street and Reliance negotiated all pricing and payment terms, including RML expenses, and Reliance disclosed to Wall Street that the residual market charges differed from its rate filings. Wall Street bargained for other terms that reduced its insurance costs and that also varied from Reliance's rate filings. Other large employers in the certified class negotiated customized insurance packages that were designed to meet their specified needs at the lowest cost; the policyholders did not want insurance programs that were constricted by filed rating plans; they bargained for

programs that departed from filed rates; and, although the programs included residual market charges, they had other features that reduced net costs to below what could have been charged under filed rates. Defendants argue that "each negotiation among a policyholder, its broker, and its insurer created a unique record of oral and written communications directly relevant to the RICO fraud claim." Appellants Br. at 5.

Defendants contend that, due to their complexity, retrospectively rated workers' compensation insurance policies are almost always written for large employers who pay annual premiums that can amount to millions of dollars. Policyholders usually operate in several states and require multiple lines of insurance coverage. Consequently, they frequently request that brokers seek proposals from several carriers. The brokers, in turn, solicit proposals that include requested coverage, services, and payment terms for many types of insurance, including workers' compensation, general liability, and commercial automobile liability, to insure the policyholder in multiple states. Quoted premiums often specify one formula for all such coverage. Negotiations can include face-to-face meetings, telephone conversations, and correspondence that vary in form depending on the deal. Brokers and others, such as professional risk managers, insurance consultants, and lawyers, frequently participate. Employers and their representatives negotiate customized retrospectively-rated programs that reflect their different operations, risk tolerances, coverage needs, and cash-flow preferences. They also bargain for premium formulas and payment terms that vary according to program.

Defendants also posit that policyholders sought ways to reduce their costs below those set by filed rating plans.

Carriers and policyholders negotiated rates that were not as provided in filed rating plans or state regulations, thereby reducing overall program prices below levels that could be charged under the plans. The total cost of the negotiated program depended on many individually-negotiated terms, and the fact that one premium factor, such as the tax multiplier, was higher than that prescribed in a filed plan did not necessarily cause the net cost to exceed what the filed plan allowed. Policyholders usually focused on lowest net cost, not on a single component of cost.

B

Wall Street moved for class certification. Defendants opposed the motion, contending that Wall Street had failed to meet its burden of establishing the adequacy and typicality requirements of Rule 23(a) and the predominance, manageability, and superiority requirements of Rule 23(b)(3). They argued, *inter alia,* that proof concerning the fraud-based RICO claims would necessarily focus on the knowledge of the thousands of employers, brokers, agents, and other insurance personnel who participated in negotiating the insurance programs, and that a trial would consist of evidence concerning thousands of oral and written communications that formed essential parts of these negotiations. Defendants contended that individual issues concerning these communications and the knowledge of each transaction's participants would vastly predominate over any common issues. Following an evidentiary hearing, the district court certified the following class:

> All purchasers (excluding policyholders with a captive insurance company that ultimately

> reinsure their workers' compensation risk, the defendants and co-conspirators) of workers' compensation insurance policies, effective on or after January 1, 1987, endorsed with a Retrospective Premium Endorsement (NCCI form WC 00 05 series) and not closed by a final premium calculation on or before May 6, 1994, excluding purchasers of policies endorsed as a Large Risk Alternative Rating Option[.]

Sandwich Chef of Tex., Inc. v. Reliance Nat'l Indem. Ins. Co., 202 F.R.D. 484, 504 (S.D. Tex. 2001) ("*Sandwich Chef II*").

In the context of analyzing Rule 23(b)(3) predominance, the district court rejected defendants' argument that a trial of class claims was impossible due to the predominance of individual issues. *Id.* at 497. The court noted that RICO required both "but for" and "proximate" causation. *Id.* It held that, under our decision in *Summit Properties Inc. v. Hoechst Celanese Corp.*, 214 F.3d 556, 558-61 (5th Cir. 2000), proximate cause in a RICO fraud case could be established if the plaintiff had either been the target of fraud – the target wing – or had relied on the fraudulent conduct of the defendants – the reliance wing. It concluded that Wall Street had stated a claim under both. *Id.*

The court reasoned that Wall Street could establish causation under the target wing of *Summit* – where individual reliance by class members would not be an issue – based on a fraud-on-the-regulator theory. *Id.* Applying a conclusion it had reached in its earlier summary judgment ruling in *Sandwich Chef of Texas, Inc. v. Reliance National Indemnity Insurance Co.*, 111 F.Supp.2d 867 (S.D. Tex. 2000) ("*Sandwich Chef I*"), the court held

that Wall Street could meet the requirement of proximate cause by establishing that class members had been injured by regulators' reliance on defendants' misrepresentations and omissions. *Id.* at 497-98 (citing *Sandwich Chef I,* 111 F.Supp.2d at 876, in which it held that "Wall Street's fraud-on-the-regulator [theory] is cognizable as a RICO claim after *Summit* because Wall Street has established through the summary judgment evidence that the defendants engaged in a scheme to collect phantom premiums through misrepresentations made to insurance regulators."). Wall Street argued that, when NCCI made its R-1244 filing seeking authority for residual market subsidies in filed rates, it concealed that many defendants were already charging these costs to policyholders. It asserted that the filing misrepresented that defendants intended only a "partial pass-through" of these costs when they in fact charged policyholders a full pass-through. *Id.* at 498. Wall Street also contended that individual defendants made similar deceitful representations directly to regulators that were intended to lead them to believe that defendants were charging filed, rather than inflated, rates. *Id.*

The district court rejected defendants' contention that members of the plaintiff class would be required to demonstrate injury through individual proof. It concluded that Wall Street could first show that regulators relied upon the filings and would have enforced the filed rates. Defendants' conduct, if proved, would demonstrate they understood the necessity of concealing their actual charges by making deceitful filings in violation of state laws, and the impact of their alleged scheme affected all class members the same. *Id.* Wall Street had established predominance

and superiority for its target wing claim because its fraud-on-the-regulator theory was a common issue faced by all class members that could be proved or disproved at trial from a common set of facts under a single federal law. *Id.* at 498-99.

The district court also held that Wall Street could meet its obligation to prove proximate cause, without requiring individual proof of reliance, through the reliance wing of *Summit* by means of its invoice theory. *Id.* at 499. The court recognized that, in *Patterson v. Mobil Oil Corp.*, 241 F.3d 417 (5th Cir. 2001), *Bolin v. Sears, Roebuck & Co.*, 231 F.3d 970 (5th Cir. 2000), and *Castano v. American Tobacco Co.*, 84 F.3d 734 (5th Cir. 1996), we had overruled Rule 23(b)(3) certifications because the facts required individual proof of reliance. It distinguished these cases, holding that Wall Street's invoice theory claim was simple in contrast to the ones pursued in *Patterson, Bolin,* and *Castano,* and stating that Wall Street's claim had not been directly addressed by this court. *Id.*

According to the district court's reasoning, under Wall Street's theory of the case, each class member sustained the same injury: an overcharge caused by an inflated invoice. This was classic mail fraud because defendants knowingly sent policyholders invoices that they knew were higher than the filed rates. Since defendants' records provided all information needed to measure the injury for the class and each class member, the invoice theory did not raise complicating factors that would defeat Rule 23(b)(3) certification. The invoice theory also alleged that defendants made but one type of direct misrepresentation to their policyholders: the written invoices. *Id.* at 499-500.

The district court also held that class certification was particularly appropriate when purchasers sought redress for widespread commercial abuses, and that individual proof of reliance did not preclude class certification, because the act of paying an invoice could establish circumstantial evidence of reliance. *Id.* at 500. It concluded that, in a RICO fraud case alleging overcharges, proximate cause (reliance and injury) can be proved by circumstantial evidence of the transaction that results in the overcharge. *Id.* at 500-01. Wall Street sought to prove reliance by circumstantial evidence that the invoices contained inflated premiums that constituted material misrepresentations, omissions, or both, and that the class members paid overcharges as a result. Wall Street and the class were allowed to use the invoices and payment of the invoices as circumstantial evidence of detrimental reliance. They could also present expert witness testimony that businesses customarily and reasonably rely on the accuracy of invoices, especially invoices sent by regulated entities, and that commercial transactions between businesses occur based on an ethic of honesty and fair dealing. *Id.* at 501.

C

After the district court certified a class, defendants petitioned and obtained leave to appeal under Rule 23(f). They maintain, *inter alia,* that the district court abused its

discretion in certifying a class because individual issues of reliance and causation defeat Rule 23(b)(3) predominance.[4]

II

Before we turn to the merits of this appeal, we must address a threshold matter.

Wall Street contends that defendants have improperly cited materials that are outside the evidentiary record and must be stricken.[5] It argues vigorously in its brief, and emphasized during oral argument, that defendants cannot defeat class certification based on a supposed need for individual proof of reliance, because they failed to introduce in the district court evidence that class members had any information relevant to their defense, that any class member paid premiums without relying on an invoice, that a defendant disclosed the fraud to a class member, or that a class member learned about overcharging on its own. Wall Street also maintains that defendants introduced no proof that demonstrated a need to involve individual class members in the trial, that entitled defendants to question individual plaintiffs about reliance or other issues, or that showed that any class member knew about

[4] Defendants also argue that proving injury presents significant individual issues of fact and variations in state law; that conspiracy allegations do not eliminate the predominance of individual issues that defeat class certification; and that a class action is not superior to other available methods of adjudication. In view of our disposition of defendants' first argument, we need not address these contentions.

[5] Wall Street also moved to strike defendants' brief and reply brief and to vacate our order granting them leave to appeal. A panel of this court denied the motion.

the illegality of the overcharges or paid a bill without relying on an invoice.

We disagree with Wall Street's argument to the extent it is addressed to evidence we have considered on appeal.[6] In concluding that individual issues predominate in this case, we have relied on evidence that defendants maintain shows that Wall Street and other potential class members, directly or through others, negotiated premiums that varied from filed rates, and that they were aware that carriers were charging them more than the filed rate.[7] Defendants have established that they included this evidence in the certification record by submitting it as prehearing filings or proffering it during the hearing. The district court did not restrict the record to what was admitted in evidence during the hearing. In its class certification ruling, it explicitly considered "the motion, submissions, and applicable law, together with the evidence and arguments of counsel presented at a class certification hearing[.]" *Sandwich Chef II,* 202 F.R.D. at 487. On several occasions during the hearing, the district court confirmed this more expansive intent concerning the scope of the decisional record. *See* R. 42:45[8] ("You can get

[6] Wall Street objects to 140 citations that defendants make to materials that it contends are outside the class certification record. We have neither relied on any evidence that the district court explicitly excluded nor on factual recitations contained in state court cases that defendants maintain are similar to the instant action.

[7] We reject Wall Street's assertions in its brief and at oral argument that defendants did not adduce evidence in the district court to support their allegations of individual negotiations and knowledge and lack of reliance on alleged misrepresentations.

[8] Citations are to the volume and page of the record on appeal.

whatever you want in the record. Okay? I'm letting you because of the scope of this thing."); R. 44:170 ("I'm just going to leave it to both sides to determine if it was in [the record] or not. Let's not get bogged down on that. If there is any question at all, once the record is prepared, look in there; and if anything needs to be withdrawn or added, you do it."). For example, when defendants offered in evidence an expert report that they had submitted as an exhibit to their memorandum in opposition to class certification, the district court stated that this was unnecessary because the document was already part of the record. R. 43:132 ("It's already part of the file. I needn't rule on it. Let's leave it not in evidence, but it's part of the record in this case.").

Citing *Jones v. Diamond,* 519 F.2d 1090 (5th Cir. 1975), and *Ezell v. Mobile Housing Board,* 709 F.2d 1376 (11th Cir. 1983), Wall Street argues that, once the hearing is complete, only the evidentiary record determines certification, and that materials not in the record, such as exhibits to prehearing briefs, are not considered. *Jones* and *Ezell* are distinguishable. In *Jones* we held that the district court was not legally compelled to consider facts included in interrogatory answers that the plaintiff had not formally introduced in evidence. *Jones,* 519 F.2d at 1098. We did not hold that such evidence is inadmissible *per se,* nor were we deciding a case like this one, in which the district court clearly opted to consider submissions that were not admitted in evidence during the hearing.[9] In

[9] Another holding in *Jones* supports defendants' position. We concluded that "[i]f the court finds ... that an evidentiary hearing on the class is appropriate or essential, it should inform the parties that a full

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Ezell the Eleventh Circuit rejected appellants' reliance on appeal on statistical exhibits and allegations that they had not introduced during the evidentiary hearing but that were merely part of their motions for partial summary judgment and for class certification. *Ezell,* 709 F.2d at 1380. It held that the district court could not consider the exhibits and allegations because they had not been presented as evidence on the certification issue. *Id.* There is no indication in *Ezell* that, as in this case, the district court advised the parties that it would consider, and did in fact base its decision on, submissions that were not introduced during the evidentiary hearing.

The evidence on which defendants rely to contend there are individual issues of reliance and causation is properly part of the record below and on appeal.

III

We turn now to the merits. Defendants contend the district court abused its discretion in certifying this case as a class action because, *inter alia,* individual issues of reliance and causation defeat Rule 23(b)(3) predominance.[10]

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hearing will precede the decision on certification, and that any facts on which they intend to rely to support the motion must be introduced in evidence at that time." *Id.* at 1099. In the present case, the district court did not advise the parties that the facts would be limited to those introduced during the hearing; it did the opposite.

[10] Defendants also argue that the district court abused its discretion in its application of the filed rate doctrine and the parol evidence rule. We need not address these contentions. Wall Street acknowledged during oral argument that the filed rate doctrine and parol evidence

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A

We review the district court's class certification decision for abuse of discretion. *Stirman v. Exxon Corp.*, 280 F.3d 554, 561 (5th Cir. 2002). "If the court's certification was 'erroneous as a matter of law,' however, the court necessarily abused its discretion and the class should be decertified." *Sikes v. Teleline, Inc.*, 281 F.3d 1350, 1359 (11th Cir. 2002) (quoting *Jackson v. Motel 6 Multipurpose, Inc.*, 130 F.3d 999, 1006 (11th Cir. 1997)). "A district court by definition abuses its discretion when it makes an error of law." *Koon v. United States*, 518 U.S. 81, 100 (1996) (citing *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405 (1990)). We review the district court's legal conclusions *de novo*. *See Stirman*, 280 F.3d at 562.

To obtain class certification,

> Rule 23(a) requires the plaintiff to show that the class is too numerous to allow simple joinder; there are common questions of law or fact; the claims or defenses of the class representatives are typical of those of the class; and the class representatives will adequately protect the interests of the class. To receive (b)(3) certification, a plaintiff must also show that the common issues

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rule "cannot eliminate materials that would be exculpatory" and asserted that the district court did not exclude evidence on this basis. *See* Tr. Oral Arg. at 22-23. We agree that neither the filed rate doctrine nor the parol evidence rule prevents a carrier from defending against a fraud claim based on evidence that a policyholder knew of, or agreed to, the rate being charged. And the district court's certification opinion indicates that its discussion of this doctrine and rule related mostly to its assessment of typicality and did not affect its analysis of the predominance component of Rule 23(b)(3), on which this appeal turns.

> predominate, and that class treatment is the superior way of resolving the dispute.

Patterson, 241 F.3d at 418-19 (footnotes omitted). The party seeking certification bears the burden of proof. *Stirman,* 280 F.3d at 562. To decide whether common issues predominate, the district court must consider how a trial on the merits would be conducted if a class were certified. *Castano,* 84 F.3d at 740.

Causation is one issue to be tried in the present case. "RICO creates a civil cause of action for ' '[a]ny person "injured in his business or property by reason of a violation of section 1962." ' " *St. Paul Mercury Ins. Co. v. Williamson,* 224 F.3d 425, 439 (5th Cir. 2000) (quoting *Beck v. Prupis,* 529 U.S. 494, 496 (2000) (quoting 18 U.S.C. § 1964(c))).[11] The "by reason of" language of RICO has been interpreted by the Supreme Court, *Holmes v. Securities Investor Protection Corp.,* 503 U.S. 258 (1992), and by this court, *Summit,* 214 F.3d at 558, to require a showing that the fraud was the "but for" cause and "proximate" cause of the injury. "[*Holmes*] explicitly confirmed that the 'by reason of' language in RICO requires a causal connection between the predicate mail or wire fraud and a plaintiff's injury that includes 'but for' and 'proximate' causation." *Summit,* 214 F.3d at 558. In common law fraud cases, proof of reliance satisfies the "but for" cause, or cause-in-fact, requirement. *See* Restatement (Second) of

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[11] "All RICO violations under 18 U.S.C. § 1962 entail '(1) a person who engages in (2) a pattern of racketeering activity, (3) connected to the acquisition, establishment, conduct, or control of an enterprise.' " *In re MasterCard Int'l Inc.,* 313 F.3d 257, 261 (5th Cir. 2002) (quoting *Crowe v. Henry,* 43 F.3d 198, 204 (5th Cir. 1995)).

Torts § 546 (1977) ("The maker of a fraudulent misrepresentation is subject to liability for pecuniary loss suffered by one who justifiably relies upon the truth of the matter misrepresented, if his reliance is a substantial factor in determining the course of conduct that results in his loss."). For a misrepresentation to cause an injury, there must be reliance. Knowledge of the truth defeats a claim of fraud because it eliminates the deceit as the "but for" cause of the damages. *See Summit,* 214 F.3d at 560 n.19 ("If the relevant decisionmakers knew the limitations of the product but would have bought it anyway because of its low price, for example, the fraud would not have been a 'but-for' cause of the plaintiffs' damages."); *Ideal Dairy Farms, Inc. v. John Labatt, Ltd.,* 90 F.3d 737, 746-47 (3d Cir. 1996) (affirming dismissal of RICO fraud claim because plaintiff knew true facts and could not have relied on misrepresentation) (cited in *Summit,* 214 F.3d at 560 n.16).

Proximate cause generally demands that a misrepresentation be relied upon by the plaintiff, individually. *See Summit,* 214 F.3d at 562 ("[W]hen civil RICO damages are sought for injuries resulting from fraud, a general requirement of reliance *by the plaintiff* is a commonsense liability limitation." (emphasis added)). RICO fraud cases "require a showing of detrimental reliance *by the plaintiff,* which is consistent with *Holmes*' admonition that federal courts employ traditional notions of proximate cause when assessing the nexus between a plaintiff's injuries and the underlying RICO violation." *Id.* at 560 (footnote omitted) (emphasis added); *see Bolin,* 231 F.3d at 978 ("[A] finding of RICO fraud liability requires a showing of reliance by *each plaintiff.*" (emphasis added)).

"[I]ndividual findings of reliance necessary to establish RICO liability and damages preclude . . . (b)(3) certification[.]" *Bolin,* 231 F.3d at 978. "Claims for money damages in which individual reliance is an element are poor candidates for class treatment, at best. We have made that plain." *Patterson,* 241 F.3d at 419. "According to both the advisory committee's notes to rule 23(b)(3) and this court's decision in *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 482 F.2d 880 (5th Cir. 1973), a fraud class action cannot be certified when individualized reliance will be an issue." *Castano,* 84 F.3d at 745. This is so because cases that involve individual reliance fail the predominance test.

> While there may be an issue of fact common to all class members . . . that question does not predominate over the question of whether or not each member of the class suffered a RICO injury. . . . To determine reliance for each individual class member would defeat the economies ordinarily associated with the class action device.

Patterson, 241 F.3d at 419. When a district court certifies a case as a class action, despite the fact that the predominance requirement cannot be met, it errs as a matter of law. *See id.*

The pervasive issues of individual reliance that generally exist in RICO fraud actions create a working presumption against class certification. The district court avoided individual issues of reliance by concluding on substantive grounds that these issues would not predominate. If the court erred in these holdings, its class certification decision was necessarily an abuse of discretion and must be reversed. *See Sikes,* 281 F.3d at 1359.

B

Relying on our decision in *Summit,* the district court held for two reasons that Wall Street could circumvent individual issues of reliance and causation that usually preclude a finding of predominance. We ruled in *Summit* that, "[i]n general, fraud addresses liability between persons with direct relationships – assured by the requirement that a plaintiff has either been the target of a fraud or has relied upon the fraudulent conduct of the defendants." *Summit,* 214 F.3d at 561. The district court concluded that Wall Street could establish proximate cause as to all class members through common circumstantial evidence, either by the target wing or the reliance wing.

We turn first to the reliance wing, which the district court found Wall Street had met through its invoice theory. The district court viewed Wall Street's invoice theory as a relatively simple one. *Sandwich Chef II,* 202 F.R.D. at 499. Each class member was overcharged by means of an inflated invoice that affirmatively misrepresented that the premium charged was the amount lawfully due. *See id.* Individual proof of reliance was not an obstacle to class certification because the act of payment of invoices could establish circumstantial evidence of reliance. *Id.* at 500. This circumstantial evidence consisted of proof that the invoices contained material misrepresentations – inflated premiums – and that the class members had paid overcharges in reliance on the invoices. *Id.* The plaintiff class could "present expert witness testimony that businesses customarily and reasonably rely on the accuracy of invoices, especially invoices sent by regulated entities, and that commercial transactions between businesses occur based on an ethic of honesty and fair dealing." *Id.* at 501.

We conclude that this reasoning is legally flawed. Certification of a class under Rule 23(b)(3) requires that the district court consider how the plaintiffs' claims would be tried. *See Castano,* 84 F.3d at 744. "A district court certainly may look past the pleadings to determine whether the requirements of rule 23 have been met. Going beyond the pleadings is necessary, as a court must understand the claims, *defenses,* relevant facts, and applicable substantive law in order to make a meaningful determination of the certification issues." *Id.* (footnote omitted) (emphasis added). "Absent knowledge of how [the] . . . cases [will] actually be tried, however, [makes it] impossible for the court to know whether the common issues would be a 'significant' portion of the individual trials." *Id.* at 745. Although the district court recognized the need to address how a trial on the merits would be conducted, *see Sandwich Chef II,* 202 F.R.D. at 494, it did not adequately account for individual issues of reliance that will be components of defendants' defense against RICO fraud.

Defendants maintain that Wall Street and other potential class members, directly or through others (e.g., brokers), negotiated premiums that varied from filed rates for retrospectively rated workers' compensation insurance. They contend that plaintiffs were aware that carriers were charging them more than the filed rates. Knowledge that invoices charged unlawful rates, but did so according to a prior agreement between the insurer and the policyholder, would eliminate reliance and break the chain of causation. *See Summit,* 214 F.3d at 560 n.19; *Ideal Dairy Farms,* 90 F.3d at 746-47. Defendants have introduced evidence that Wall Street and other class members individually negotiated with insurers regarding workers' compensation insurance premiums. A class cannot be certified when

evidence of individual reliance will be necessary. *See, e.g., Patterson,* 241 F.3d at 419 ("Claims for money damages in which individual reliance is an element are poor candidates for class treatment, at best.").

Wall Street and the other plaintiffs must establish at trial that they detrimentally relied on the misrepresentations in the invoices the insurers sent them. Defendants are entitled to attempt to undercut this proof with evidence that might persuade the trier of fact that policyholders knew the amounts being charged varied from rates filed with regulators and that they had agreed to pay such premiums. Although expert testimony about business practices regarding invoices and commercial transactions might convince the trier of fact to find in a policyholder's favor, such opinion evidence would not justify excluding proof demonstrating a lack of reliance by individual plaintiffs. The trier of fact must ultimately decide whether a specific policyholder thought an invoice complied with the approved rate and paid an inflated premium in reliance on that belief.

Accordingly, we hold that the invoice theory does not satisfy the reliance wing of *Summit* and eliminate individual issues of reliance and causation that preclude a finding of predominance of common issues of law or fact. *See id.* (holding that facts of case required individual proof of reliance that would "defeat the economics ordinarily associated with the class action device").[12]

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[12] In a post-argument brief, Wall Street maintains that a holding in the Third Circuit's recent decision in *In re Linerboard Antitrust Litigation,* 305 F.3d 145 (3d Cir. 2002), rejects defendants' position

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C

The district court also concluded that Wall Street could avoid individual issues of reliance under *Summit*'s target wing, based on a theory of fraud-on-the-regulator. The court reasoned that, under the target wing, individual reliance by class members was not an issue because reliance upon a fraudulent representation or omission by a third person was sufficient if the plaintiff was injured as a result. Wall Street could establish proximate cause by demonstrating that the class members were injured by the regulators' reliance on defendants' misrepresentations and omissions. *Sandwich Chef II,* 202 F.R.D. at 497. The court rejected defendants' contention that individual proof of injury was necessary. It concluded that Wall Street could show that regulators relied upon carrier filings and would have enforced the filed rates; defendants' conduct, if proved, would show that they understood it was necessary to conceal their actual charges by making deceitful filings in violation of state laws; and the impact of defendants' alleged scheme affected all class members the same. *Id.* at 498. Therefore, Wall Street's target wing claim based on a fraud-on-the-regulator theory was a common issue faced by all class members that could be proved or disproved at trial from a common set of facts under a single federal law. *Id.* at 498-99.

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concerning the necessity for individual proof concerning policyholders' knowledge under the reliance wing. The holding and reasoning of *Linerboard* that plaintiffs cite does not affect our analysis, and we need not address their argument.

We hold that the district court erred in concluding that the target theory could be invoked to excuse proof of individual reliance on fraudulent predicate acts. We have applied the target theory narrowly. *See Procter & Gamble Co. v. Amway Corp.*, 242 F.3d 539, 564 (5th Cir. 2001) (referring to target theory set out in *Summit* as narrow exception to rule that in civil RICO claims in which fraud is alleged as predicate act, reliance on fraud must be shown). In *Summit* we cited *Mid Atlantic Telecom, Inc. v. Long Distance Services, Inc.*, 18 F.3d 260, 263-64 (4th Cir. 1994), as holding open, under the target wing, "the possibility that a plaintiff company may not need to show reliance when a competitor lured the plaintiff's customers away by fraud directed at the plaintiff's customers." *Summit*, 214 F.3d at 561. But we declined to apply the theory because the plaintiffs did not contend they were the targets of a scheme to defraud accomplished by defrauding others. *Id.*

Mid Atlantic involved RICO fraud and conspiracy claims by Mid Atlantic Telecom, Inc. ("*Mid Atlantic*"), a reseller of long distance telecommunications services, against Long Distance Services, Inc. ("LDS"), its competitor, and LDS's president. Mid Atlantic alleged that it had been injured by LDS's fraudulent conduct directed toward some of LDS's own customers. By improperly inflating the customers' bills, LDS was able to offer Mid Atlantic's customers artificially low rates and force Mid Atlantic to match the rates in order to keep its customers. *Mid Atlantic*, 18 F.3d at 261. The Fourth Circuit rejected defendants' argument that Mid Atlantic could not establish proximate cause because their alleged conduct had been directed toward customers of Mid Atlantic and LDS rather than toward Mid Atlantic. *Id.* at 263. The court

held that, with discovery, Mid Atlantic might be able to prove that, although defendants initially aimed the scheme only at LDS's customers, the company president broadened the scheme to include Mid Atlantic as a direct target, and discovery might reveal that the artificially low billings to Mid Atlantic customers were purposely devised to injure Mid Atlantic. *Id.* This was so because Mid Atlantic did not seek derivative injuries; it claimed distinct and independent injuries caused by the necessity of offering lower rates to match LDS's fraudulent ones. *Id.* at 264.

In *Procter & Gamble* we applied the target theory to hold that Procter & Gamble had stated a RICO claim sufficient to survive Rule 12(b)(6) dismissal where its competitor had allegedly spread a rumor that caused consumers to stop purchasing Procter & Gamble's products. *Procter & Gamble,* 242 F.3d at 565. We concluded that, even though Procter & Gamble had not relied on the fraud, if its customers had done so in deciding to boycott its products, this reliance could fall within the narrow exception carved out in *Summit* and would suffice to show proximate cause. *Id.*

The reasons for our narrow application of the target theory, and for its inapplicability in the present case, can be derived from foundational principles of RICO causation jurisprudence. Before the Supreme Court decided *Holmes,* "[t]he Courts of Appeals ha[d] overwhelmingly held that not mere factual, but proximate, causation is required." *Holmes,* 503 U.S. at 266 n.11. *Holmes* agreed with the lower courts' conclusion – "[p]roximate cause is thus required," *id.* at 268 – and it gave meaning to the concept of proximate cause in the context of civil RICO:

> Here we use "proximate cause" to label generically the judicial tools used to limit a person's responsibility for the consequences of that person's own acts. At bottom, the notion of proximate cause reflects "ideas of what justice demands, or of what is administratively possible and convenient." Accordingly, among the many shapes this concept took at common law was a demand for some *direct relation between the injury asserted and the injurious conduct alleged.* Thus, a plaintiff who complained of harm *flowing merely from the misfortunes visited upon a third person* by the defendant's acts was generally said to stand at *too remote a distance to recover.*

Id. at 268-69 (emphasis added) (quoting W. Keeton, D. Dobbs, R. Keeton, & D. Owen, *Prosser and Keeton on Law of Torts* § 41, at 264 (5th ed. 1984)) (other citations omitted).

In enacting RICO, Congress obviously adopted "the Clayton Act direct-injury limitation among the requirements of § 1964(c)." *Id.* at 272. *Holmes* relied on three reasons for concluding that such directness of relationship has been one of the central elements of causation. *Id.* at 269 (addressing requirements of Clayton Act, but stating *infra* at 270 "that the facts of the instant case show how these reasons apply with equal force to suits under § 1964(c)."). "First, the less direct an injury is, the more difficult it becomes to ascertain the amount of a plaintiff's damages attributable to the violation, as distinct from other, independent, factors." *Id.* (citation omitted). "Second, quite apart from problems of proving factual causation, recognizing claims of the indirectly injured would force courts to adopt complicated rules apportioning damages among plaintiffs removed at different levels of

injury from the violative acts, to obviate the risk of multiple recoveries." *Id.* (citations omitted). Third, "the need to grapple with these problems is simply unjustified by the general interest in deterring injurious conduct, since directly injured victims can generally be counted on to vindicate the law as private attorneys general, without any of the problems attendant upon suits by plaintiffs injured more remotely." *Id.* at 269-70 (citation omitted).

Holmes therefore teaches that a RICO plaintiff must show a "direct relation between the injury asserted and injurious conduct alleged[,]" and that a RICO predicate act "visited upon a third person" is generally too remote to permit a recovery from a person who complains of injury flowing from that act. *Id.* at 268. Consistent with this understanding of *Holmes,* we held in *Summit* that the plaintiffs could not establish reliance on defendants' fraud because their "risks of injuries did not arise as direct and contemporaneous results of any alleged fraud, but instead arose only later, through the purchases of allegedly defective plumbing by transactions which were not tainted with fraud." *Summit,* 214 F.3d at 561 n.22 (citations omitted).

Thus under the target wing recognized in *Summit* and applied in *Procter & Gamble,* there is a narrow exception to the requirement that the plaintiff prove direct reliance on the defendant's fraudulent predicate act. This exception only comes into play when the plaintiff can demonstrate injury as a direct and contemporaneous result of fraud committed against a third party, because in this limited context there is a sufficient "direct relation between the injury asserted and the injurious conduct alleged" to comport with the RICO requirement of proximate cause. This understanding of *Holmes* and our jurisprudence clearly explains how the narrow exception was correctly

applied in *Mid Atlantic* and *Procter & Gamble*. The facts of these cases illuminate the guiding principle of *Summit*'s narrow exception and the critical distinction between cases that properly apply it and those that do not.[13]

In *Mid Atlantic* and *Procter & Gamble* there were direct and contemporaneous relationships between the acts of fraud directed against the third parties and the harm the plaintiffs incurred. When Mid Atlantic's customers relied on fraudulent communications about rates, it had to lower its charges to avoid losing them as customers. When Procter & Gamble's competitor spread false rumors, it lost sales due to a customer boycott. The risks of injuries arose in both *Mid Atlantic* and *Procter & Gamble* as direct and contemporaneous results of the allegedly fraudulent predicate acts.

But the exception adopted in *Summit* has clear and constricted parameters that Wall Street cannot satisfy in this case. Under Wall Street's target theory, there is no similar direct and contemporaneous relationship between the fraudulent acts directed against regulators and the harm Wall Street and the other plaintiffs incurred. Assuming that defendants and NCCI misrepresented in regulatory filings that they were charging lawful rates, the

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[13] We have no occasion to address in all its dimensions what constitutes proximate cause in a RICO fraud case. Consistent with *Holmes*, 503 U.S. at 272 n.20, we disavow any intent to adopt a bright-line rule for establishing proximate cause in all or even most contexts. Nor do we foreclose the possibility that fraud upon a third party can constitute proof of reliance by a plaintiff under circumstances not present in today's case. We simply conclude that Wall Street's specific fraud-on-the-regulator theory is legally inadequate to avoid the necessity of proving individual reliance by policyholders.

injury to plaintiffs could have arisen only after defendants attempted to charge plaintiffs inflated premiums, and the regulators – because they had been deceived – did not intercede to prevent the fraud. When Wall Street's theory is analyzed properly, it is apparent that no injury could have been incurred without a plaintiff's subsequent reliance on an inflated invoice. The fact that a regulator was completely in the dark about a carrier's true premium charges would not of itself have injured a policyholder. We do not reject the possibility that defrauding a regulator could, in the proper case, proximately cause injury. But we hold that fraud on the regulator, as Wall Street contemplates it, does not constitute a direct and contemporaneous RICO injury to a policyholder because it would always be necessary for the regulator to be deceived *and* for the policyholder to pay an unlawfully-inflated premium. Although disclosure of the true premiums to a regulator could *prevent* injury to policyholders by prompting the regulator to interdict the carrier's attempt to bill at an inflated rate, concealment of inflated premiums would not result in direct and contemporaneous injury to the policyholder without the additional act of billing. The regulator's reliance on the fraudulent act would not alone be enough to result in a direct and contemporaneous injury to a policyholder that satisfies RICO's proximate cause requirement.

We therefore disagree with the district court that the fraud-on-the-regulator theory is a common issue faced by all class members that may be proved or disproved at trial from a common set of facts. Because Wall Street cannot rely on *Summit*'s target wing, plaintiffs must demonstrate causation on an individual basis, which defeats predominance and certification of a Rule 23(b)(3) class.

* * *

The district court relied in error on certain legal principles to eliminate individual issues that predominate in this RICO fraud case and that preclude certification of a Rule 23(b)(3) class. These RICO fraud cases must be tried individually. Wall Street and other plaintiffs are entitled to prove at trial that the insurers with whom they contracted to provide workers' compensation insurance defrauded them, in violation of 18 U.S.C. § 1962, by charging premiums that exceeded approved rates. But defendants are equally entitled to defend themselves by offering, for example, evidence that an individual plaintiff, directly or through a broker, negotiated a premium that varied from the filed rate, was aware that the insurer was charging more than what regulators had approved, and therefore was not a victim of fraud. Accordingly, the class certification order is

REVERSED.

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Sandwich Chef of Texas, Inc. d/b/a Wall Street Deli, Individually and for Others Similarly Situated,	)	
Plaintiffs,	)	Civil Action No. H-98-1484
vs.	)	
Reliance National Indemnity Insurance Company f/k/a Planet Insurance Company, et al.,	)	
Defendants.	)	

ORDER

(Filed Aug. 8, 2001)

Pending before the Court is the Motion for Class Certification filed by Plaintiff Sandwich Chef of Texas d/b/a Wall Street Deli ("Wall Street"). Having considered the motion, submissions, and applicable law, together with the evidence and arguments of counsel presented at a class certification hearing conducted January 8-12, 2001, the Court determines that the motion for class certification should be granted.

I. BACKGROUND

Wall Street operates delicatessens in several states. From 1991 through 1994, Wall Street bought four workers' compensation insurance policies from Defendant Reliance Insurance Company ("Reliance"). Each policy was made

subject to retrospective rating by a "WC 00 05" endorsement. Wall Street claims that Reliance overcharged for this coverage by illegally inflating a regulated premium factor, that other Defendants did the same to their policyholders, and that all Defendants jointly conspired to overcharge policyholders and to conceal their misconduct from state regulators. The other Defendants in this case are approximately one hundred fifty insurance carriers.

Wall Street alleges that Defendants' scheme corrupted the National Council on Compensation Insurance, Inc. ("NCCI"), a private enterprise established and controlled by Defendants. NCCI is the official rating organization for many states. Acting for Defendants, NCCI files proposed rates, policy forms and manuals with state regulators for approval. Under the plan manuals approved by state regulators, NCCI is delegated other official functions. NCCI receives and then files retrospectively rated policies with state regulators and is responsible for verifying that Defendants' actual retrospective plan factors conform to plan factors approved by the states. According to Wall Street, NCCI and Defendants knowingly submitted misleading filings that were intended to, and did, lead regulators to believe that Defendants were charging filed rates when they were actually charging additional and unfiled residual market subsidies. NCCI is also alleged to have given other support to Defendants' scheme, including distributing information Defendants used to set their unauthorized charges and providing Defendants opportunities to meet and discuss their scheme.

Wall Street's complaint alleges that Defendants' scheme to defraud policyholders violated the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 ("RICO"). Wall Street seeks to recover RICO

damages for itself and a proposed class of employers who purchased retrospectively rated workers' compensation insurance in one or more of forty-four states and the District of Columbia.

Wall Street seeks damages proximately caused by two aspects of Defendants' alleged scheme. First, Wall Street asserts that Defendants made false filings with state regulators that allowed them to charge illegal premiums (fraud-on-the-regulator theory). Second, Wall Street asserts that Defendants sent invoices demanding amounts above those prescribed by Defendants' applicable rate filings in the relevant jurisdictions (invoice theory).

Wall Street filed its motion for class certification on December 3, 1999. The parties submitted extensive briefing on the motion for class certification, and the Court conducted an evidentiary class certification hearing from January 8 through January 12, 2001.

II. WALL STREET'S PROPOSED CLASS & PROPOSED TRIAL PLAN

A. Proposed Class

Wall Street moves to certify the following class:

> All purchasers of workers' compensation insurance policies, effective on or after January 1, 1987, endorsed with a Retrospective Premium Endorsement (NCCI form WC 00 05 series) and not closed by a final premium calculation on or before May 6, 1994; except for purchasers of policies endorsed as a Large Risk Alternative Rating Option (LRARO), purchasers that participated in captive insurance that reinsures their risk, and defendants and co-conspirators.

Wall Street explains the proposed class definition as follows. The required endorsements, WC 00 05 series, are the standard forms for Option V workers' compensation policies.[1] All risk in a state covered by a WC 00 05 endorsement is subject to the same formula for calculating premiums, the same filing requirements, and the same authorized rating plan factors.

The January 1, 1987 start date for membership in the class is the approximate time Defendants are alleged to have first met at NCCI and discussed requiring policyholders to bear all costs associated with assigned risk pools, the alleged motive for Defendants' scheme. May 6, 1994 is four years before the date Wall Street filed its RICO complaint. The requirement that a policy not have been closed by a final premium calculation on or before this date ensures that the class contains only policyholders that received invoices for workers' compensation premiums within the four year limitations period.

The class definition excludes coverage written under a Large Risk Alternative Rating Option ("LRARO") endorsement. LRARO coverage differs from Option V coverage in that, under LRARO, the retrospective formula and plan factors are negotiable. The exclusion of policyholders with captive reinsurers removes policyholders who, in effect, would have been overcharging themselves. The exclusion of Defendants and co-conspirators serves the purpose of avoiding an intraclass conflict.

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[1] The term "Option V" refers to all retrospective plans written during the class period that are governed by the same rating plan and endorsements that were, prior to December 1, 1991, specifically identified as "Option V."

B. Proposed Trial Plan

In addition to its motion to certify the class, Wall Street filed a Proposed Trial Plan and a Supplemental Proposed Trial Plan (the "Trial Plan"). The Trial Plan identifies three phases to manage the proposed class: legal issues, factual issues, and damages.

Phase one would require the Court to decide pertinent legal issues.[2] Namely, the Court would need to: (1) determine whether Defendants were legally required, by the applicable state laws, to use filed rating plan factors when charging for Option V coverage; (2) assemble a grid of required filed rating plan factors or verify that same are contained in the "RQS" computer program[3] (qualified, if need be, by company-specific filings); (3) determine whether reliance is self-proving as a matter of law for policyholders who received and paid invoices; (4) classify disputed policies as Option V or LRARO; (5) determine the significance of "side agreements" in the policies; (6) decide whether to allow Defendants to assert counterclaims against absent class members; and (7) review test runs of actual damage formulas on samples of actual account information to ensure presentation of damages figures in proper form.

Phase two would involve a jury determination of factual issues. The factfinder would be asked to decide: (1)

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[2] The Court has already made a number of preliminary legal determinations as identified in Section IV(A)(2) *infra*.

[3] "RQS" stands for NCCI's Retro Quote System, a computer system created by NCCI that contains a complete set of tables showing the lawful rates for Option V coverage in every state throughout the class period.

whether Defendants conspired to charge Option V policyholders residual market subsidies that exceeded the subsidies provided for in the filed tax multipliers; (2) whether Defendants committed mail fraud by sending out invoices demanding unauthorized premium charges; (3) whether Defendants committed mail fraud by sending rate filings to state insurance regulators misrepresenting the amounts they would charge policyholders for insurance coverage; (4) whether Defendants used the NCCI to effectuate their conspiracy through a pattern of racketeering activity; (5) whether payment of an inflated invoice constitutes reliance for the purpose of establishing proximate cause under RICO; (6) whether Option V policyholders were direct targets of Defendants' scheme, thereby establishing proximate cause under RICO; and (7) the amount by which Defendants overcharged Wall Street individually and the class as a whole.

Phase three, applicable only if the class prevails, would involve distribution of damages to the class. Individual damages would be distributed on the basis of records obtained from Defendants and, if necessary, proof of claim forms submitted by members of the class.

III. Defendants' Opposition To Class Certification

Defendants argue that certification is inappropriate because Wall Street has failed to meet its burden of establishing the adequacy and typicality requirements of Rule 23(a) and the predominance, manageability, and superiority requirements of Rule 23(b)(3). Defendants contend that proof concerning the fraud-based RICO claims will necessarily focus on the knowledge of the thousands of employers, brokers or agents, and other

insurance personnel that participated in the negotiation of the insurance programs.

Defendants also assert that a trial would consist of evidence concerning thousands of oral and written communications that formed an essential part of these negotiations, and that individual issues concerning these communications and the knowledge of each transaction's participants would vastly predominate over any common issues that might arise. Defendants argue that trying these claims would require consideration of the laws of forty-five jurisdictions regarding issues such as the applicability of varying and possibly conflicting rate filings as well as the enforceability of agreements that vary from those filings. Defendants also contend that compulsory counterclaims, defenses, and arbitration agreements are fatal to the motion for certification.

IV. Class Certification Under Rule 23

To attain certification of the proposed class, Wall Street must meet each of the four requirements of Rule 23(a): numerosity, commonality, typicality, and adequacy. *See* Fed. R. Civ. P. 23(a). Because Wall Street seeks to certify the class under Rule 23(b)(3), it must also show that common issues predominate and that class treatment is the superior method to resolve the dispute. *See* Fed. R. Civ. P. 23(b)(3).

Wall Street bears the burden of proof on class certification. *See Castano v. Am. Tobacco Co.*, 84 F.3d 734, 740 (5th Cir. 1996). The district court may certify a class only if a "rigorous analysis" convinces it that all conditions set out in Rule 23 are met. *Id.* In so doing, the court must consider "how a trial on the merits would be conducted" if

a class were certified. *Id.* A district court may look past the pleadings to determine if Rule 23's requirements have been met. *Id.* at 744. This necessitates looking "beyond the pleadings . . . [to] understand the claims, defenses, relevant facts, and applicable substantive law in order to make a meaningful determination of the certification issues." *Id.*

A. Rule 23(a) Requirements

1. Numerosity

In this case, Defendants concede numerosity. Accordingly, the Court need not address whether the class is so numerous that joinder of all members is impracticable. *See* FED. R. Civ. P. 23(a)(1).

2. Commonality

Rule 23(a)(2) requires that there are questions of law or fact common to the class. FED. R. Civ. P. 23(a)(2). "The threshold of 'commonality' is not high." *Bertulli v. Indep. Ass'n of Continental Pilots,* 242 F.3d 290, 296-97 (5th Cir. 2001) (citing *Jenkins v. Raymark Indus., Inc.,* 782 F.2d 468, 472 (5th Cir. 1986)). A common question is one that, when answered as to one class member, "will affect all or a significant number of the putative class members." *Forbush v. J.C. Penney Co.,* 994 F.2d 1101, 1106 (5th Cir. 1993).

This Court's prior opinion denying Defendants' motion for summary judgment identified several issues that are

common to the proposed class.[4] The jury charge presents additional common questions. At trial, Wall Street must prove that: (1) there was an enterprise; (2) the enterprise engaged in, or had some effect upon, interstate commerce; (3) Defendants were employed by or associated with the enterprise; (4) Defendants knowingly and willfully conducted or participated, directly or indirectly, in the conduct of the affairs of the enterprise; and (5) Defendants did so through a pattern of racketeering activity. *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 (1985); *Word of Faith World Outreach Ctr. Church, Inc. v. Sawyer*, 90 F.3d 118, 121-22 (5th Cir. 1996); FIFTH CIRCUIT PATTERN JURY INSTRUCTIONS, CIVIL 8.1 (West 1999).

Furthermore, the predicate racketeering act – knowingly devising a scheme or artifice to defraud – presents common issues of fact. Racketeering activity, for purposes of mail and wire fraud, involves proof: (6) of use of the mail or wire in furtherance of the scheme and (7) that the scheme proximately caused injury to the plaintiff. *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 265-68 (1992). Wall Street alleges a nationwide fraudulent scheme devised by Defendants, and a finding concerning Defendants' participation in that scheme will apply equally to all

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[4] In that Order, the Court determined that: (1) intentional overbilling is actionable under RICO; (2) inflated invoices are misrepresentations of fact; (3) the "filed rate doctrine" does not bar Option V policyholders from suing to enforce the filed rate; (4) proximate cause can be established by showing that policyholders were direct targets of the conspiracy to overcharge; and (5) the McCarran-Ferguson Act does not preclude class members' claims. *See Sandwich Chef of Tex., Inc. v. Reliance Nat'l Indemn. Ins. Co.*, 111 F.Supp.2d 867, 873-77 (S.D. Tex. 2000).

class members. *See Heastie v. Cmty. Bank of Greater Peoria,* 125 F.R.D. 669, 674 (N.D. Ill. 1989) (noting that, under the mail fraud statute, "what is important is devising or intending to devise a scheme to defraud, and that depends only on the defendant").[5]

The existence of the conspiracy, its membership, its duration, and its characteristics are also common questions of fact. Where NCCI is alleged to be the enterprise, Wall Street must show the existence of a conspiracy because NCCI is under Defendants' joint control. A finding in Wall Street's favor on its conspiracy charges concerning the conduct of Defendants will apply to all class members. *See Murray v. Sevier,* 156 F.R.D. 235, 249 (D. Kan. 1994) (in civil RICO conspiracy claim based upon mail fraud, "it would be senseless to require each of the members [ ], numbering over half a million, to individually assert their fraud claims against the defendants, especially where a single 'underlying scheme,' rather than a variety of distinct misrepresentations, is the fundamental basis for those claims"). Given the existence of these common legal

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[5] *See also Grainger v. St. Sec. Life Ins. Co.,* 547 F.2d 303, 307-08 (5th Cir. 1977) (class actions are appropriate where a "standardized sales pitch" is employed); *Peterson v. H & R Block Tax Servs., Inc.,* 174 F.R.D. 78, 82 (N.D. Ill. 1997) (commonality exists when mail fraud involved a standard course of conduct toward class or when class members' claims arise out of standard written document); *Rohlfing v. Manor Care, Inc.,* 172 F.R.D. 330, 339 (N.D. Ill. 1997) ("by definition, parties to a contract are aware and rely on the representations or omissions in the contract"); *McMahon Books, Inc. v. Willow Grove Assoc.,* 108 F.R.D. 32, 38 (E.D. Pa. 1985) (mail fraud claim concerned single fraudulent scheme by defendants that injured all class members).

and factual issues, Wall Street has met its burden of establishing commonality. *See* FED. R. Civ. P. 23(a)(2).

3. Typicality

Rule 23(a)(3) requires that "the claims or defenses of the representative parties are typical of the claims or defenses of the class." FED. R. Civ. P. 23(a)(3). "Like commonality, the test for typicality is not demanding." *Mullen v. Treasure Chest Casino, LLC,* 186 F.3d 620, 625 (5th Cir. 1999). Typicality exists when the claims of named and unnamed plaintiffs have a common source and rest upon the same legal and remedial theories. *Id.*

The class asserts a single cause of action, RICO, with predicate acts of mail fraud and wire fraud. The alleged injuries to the class members, including Wall Street, have a common source: the alleged conspiracy to corrupt NCCI, to deceive state regulators, and to overcharge policyholders through fraudulent billings. This alleged collusion creates typicality. Because Defendants' alleged conspiracy is causally connected to every victim's loss, the victims are typical of one another. *See In re Workers' Comp.,* 130 F.R.D. 99, 106 (D. Minn. 1990) ("Nor will differing damages, resulting from varied methods of procuring and purchasing the product, defeat satisfaction of Rule 23(a)(3).").

Defendants challenge Wall Street's typicality in four ways. First, Defendants contend that Wall Street had LRARO coverage and therefore cannot be typical of Option V policyholders. According to Defendants, when a retrospectively rated policy exceeds the minimum premium threshold for LRARO eligibility, it automatically becomes a LRARO. The plain language of the insurance policy, however, defeats this argument. Each of Wall Street's

policies, like all other workers' compensation policies, contain the following merger clause:

> The only agreements relating to this insurance are stated in this policy. The terms of the policy may not be changed or waived except by endorsement issued by us to be part of this policy.[6]

This language is clear and unambiguous. *See Protective Ins. Co. v. Montgomery Tank Lines, Inc.*, No. 89-C-2793, 1990 WL 251903, at *3 (N.D. Ill. Dec. 19, 1990) ("the language of the policy is clear in its requirement that no alteration can become part of the policy until an endorsement is issued"). Parol evidence is not admissible to determine policy type or otherwise to contradict the policy. *See Hartford Acc. & Indem. Co. v. Pro-Football, Inc.*, 127 F.3d 1111, 1114 (D.C. Cir. 1997) ("[W]hen [retrospectively rated workers' compensation insurance] contracts are clear and unambiguous, they will be enforced by the courts as written"); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995) ("Parol evidence is not admissible for the purpose of creating an ambiguity" in an insurance contract that is not ambiguous). As required by the class definition, each of Wall Street's policies contains a WC 00 05 endorsement. None of Wall Street's policies contain any LRARO-specific endorsements or mentions LRARO. That Wall Street is subject to rate regulated coverage (Option V) may be determined by reference only to Wall Street's policies.

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[6] Workers' Compensation and Employers' Liability Insurance Policy, NCCI Form WC 00 00 00 A.

Second, Defendants claim that Option V policies were individually negotiated. That Option V policies may have been customized in *some* respects is not dispositive. Wall Street contends that Defendants overcharged policyholders by inflating residual market subsidies that were fixed by filed rates and adopted into the policy by a WC 00 05 endorsement. The lawfully adopted residual market subsidies were not negotiable under the WC 00 05 endorsements. Customization of other elements of the policies in the class that were subject to negotiations has no effect upon Wall Street's typicality.

Third, Defendants claim that many Option V policyholders had agreements that required them to pay higher rates than the filed rates. Defendants ask this Court to ignore the tax multipliers and residual market subsidies fixed by law and instead consider negotiations, side agreements, or unfiled endorsements that allegedly demonstrate this agreement. Defendants further argue that these items demonstrate an agreement to pay inflated rates and make each class member unique.

The testimony of the experts and fact witnesses at the certification hearing was unanimous on this point: **Defendants cannot charge more than the filed rate.** The filed rate doctrine provides that a regulated entity may not engage in price discrimination among ratepayers (i.e., all rate payers must be charged the same rate for services) and that the state regulatory agency is the exclusive source of lawful rates. *E.g., Marcus v. AT&T Corp.,* 138 F.3d 46 (2d Cir. 1998). Under this doctrine, all policyholders with coverage written under a WC 00 05 endorsement are subject to the same nonnegotiable rating plan factors, including the approved residual market subsidy. This

ensures typicality for all policyholders with WC 00 05 endorsements.

The United States Supreme Court has stated that, under the filed rate doctrine, a purchaser of a commodity regulated by a filed rate cannot be required to pay a higher rate, even if it agreed to do so. *Ark. La. Gas Co. v. Hall,* 453 U.S. 571, 582 (1981); *see also Stein v. Sprint Corp.,* 22 F.Supp.2d 1210, 1212 (D. Kan. 1998) (the policy of nondiscriminatory rates is violated when similarly situated customers pay different rates for the same services). In addition to the policy's merger clause that eliminates agreements not stated in the policy, the Court cannot recognize the existence of side agreements or understandings that, Defendants assert, make each member of the class unique. If the Court were to do so, it would aid the very discriminatory pricing practices that the filed rate doctrine is intended to preclude. Moreover, the Court cannot participate in an effort to question the filed rates. No implicated jurisdiction has allowed a carrier to defeat its filed rate by means of unfiled side agreements or understandings.[7] The Court must look only to the

[7] *Am. Mut. Liab. Ins. Co. v. Plywoods-Plastics Corp.,* 81 F. Supp. 157, 165 (E.D. S.C. 1948) (an agreement between policyholder and carrier for workmen's compensation coverage at rates other than those filed would be ineffective); *Nationwide Mut. Ins. Co. v. Ed Soules Constr. Co.,* 397 So.2d 775, 776 (Fla.App. 1 Dist. 1981) (workers' compensation premiums calculated in accordance with applicable rules, rates and rating plans); *Walker v. Bituminous Cas. Corp.,* 40 S.E.2d 228, 229 (Ga.App. 1946) (parties to a workers' compensation insurance policy do not have freedom to contract with respect to rates); *D.A.X., Inc. v. Employers Ins. of Wausau,* 659 N.E.2d 1150, 1156 (Ind.App. 1996) (trial court properly enforced workers' compensation insurance contract by using proper classification and rates); *Mike Hooks, Inc. v. Argonaut-Southwest Ins. Co.,* 370 So.2d 141, 145 (La.App. 3d Cir. 1979)

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policies of insurance, rating plans and manuals, all of which are incorporated into each class member's contract through a WC 00 05 series endorsement.[8] Wall Street has the WC 00 05 endorsement.

Fourth, Defendants challenge Wall Street's typicality because it did not purchase insurance from every Defendant. There is no such requirement, however. Civil conspiracy is a means for establishing vicarious liability upon all conspirators for the fraud committed by any member.

(legislature removed the subject of workers' compensation rates from the field of private bargaining); *Employers' Liab. Assur. Corp. Ltd. of London, Eng. v. Arthur Morgan Trucking Co.,* 156 S.W.2d 8, 12 (Mo.App. 1941) (the statute removed the subject of workers' compensation rates from field of private bargaining; rates can neither be nullified nor altered by any private bargaining or contract, or by acts or conduct on part of insurer in its dealings and relations with insured which might ordinarily constitute basis of claim of waiver or estoppel); *Mountain Fir Lumber Co. v. Employee Benefits Ins. Co.,* 679 P.2d 296, 299 (Or. 1984) (workers' compensation rates must adhere to filed rates); *Assoc. Emp. Lloyds v. Dillingham,* 262 S.W.2d 544, 546 (Tex. Civ. App. –Fort Worth 1953, writ ref'd) (statutes make any agreement or contract not written into policy void as rates on workers' compensation policies are removed from field of bargaining); *Wisconsin Comp. Rating & Inspection Bureau v. Mortensen,* 277 N.W. 679, 685 (Wis. 1938) (the filed rating plan is an effective part of the contract and the amount of the final premium to be paid by an employer is to be determined in accordance with the filed rates).

[8] The Court notes that Wall Street does not contend that premium payment agreements are per se void. Wall Street alleges only that, as a matter of law, Defendants cannot use side agreements to justify overcharges above the filed rates. Side agreements that do not run counter to the filed rates are enforceable. *See Cananwill, Inc. v. EMAR Group, Inc.,* 250 B.R. 533, 555-56 (M.D. N.C.1999) (a side agreement that "did not implicate a primary purpose" of state law was enforceable); *see also Tankersley v. Durish,* 855 S.W.2d 241, 247 (Tex. App.–Austin 1993, writ denied) ("the mere presence of an illegal side agreement does not invalidate a policy").

E.g., Beck v. Prupis, 529 U.S. 494, 503 (2000). Thus, plaintiffs in conspiracy actions can recover from defendants with whom they have never interacted. *Tompkins v. Cyr,* 202 F.3d 770, 783 (5th Cir. 2000). When defendants have allegedly conspired to take money from many victims by means of a common course of misconduct, the claims of each victim are typical. *In re NASDAQ Market-Makers Antitrust Litig.,* 169 F.R.D. 493, 511-12 (S.D.N.Y. 1996). The Court finds that Wall Street's claims and/or defenses have a common source and rest upon a single legal and remedial theory. Accordingly, Wall Street has met its burden of demonstrating that its claims are typical of the claims of the class. *See* FED. R. Civ. P. 23(a)(3).

4. Adequacy

Rule 23(a)(4) requires that "the representative parties will fairly and adequately protect the interests of the class."[9] FED. R. Civ. P. 23(a)(4). The class representatives' interests must be aligned with, and not antagonistic to, unnamed class members. *Mullen,* 186 F.3d at 625-26. A sufficient alignment of interests exists when "all class members are united in asserting a common right, such as

[9] The district court must also find that the lawyers who will be responsible for trying the case are competent to pursue the action. *E.g., In re Workers' Comp.,* 130 F.R.D. at 107; *see also Roper v. Consurve, Inc.,* 578 F.2d 1106, 1112 (5th Cir. 1978). In this case, the lawyers for the proposed class are with the firm of McClanahan & Clearman, L.L.P. and Professors Susan Klein and Charles Silver of the University of Texas School of Law. These lawyers have extensive experience and expertise in class action litigation, workers' compensation insurance, and RICO. Defendants have conceded that Wall Street's counsel meet the adequacy requirement, and the Court agrees.

achieving the maximum possible recovery for the class." *In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 208 (5th Cir. 1981); *Bertulli,* 242 F.3d at 298 n.33 (adequacy was present when class representatives did not seek relief at the expense of unnamed class members).

At the certification hearing, Wall Street's vice-chairman testified by deposition and its chief financial officer testified in person. Wall Street has produced documents and answered interrogatories, selected skilled legal counsel and conferred with its attorneys about the prosecution of the action. Professor John C. Coffee, Jr. of Columbia Law School testified that Wall Street's claim for more than $150,000 gave it an appropriate stake in the action.[10] The fact that Wall Street's claim is large does not affect class certification. Just as the participation of large-claim named plaintiffs is encouraged in securities fraud class actions, there is no reason to discourage such participation in RICO class actions.[11] Wall Street has, and can

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[10] The emerging consensus is that a sophisticated person with a sizable claim is well-suited to act as a named plaintiff. *See generally* Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions,* 104 YALE L.J. 2053 (1995) (arguing that claimants with a significant stake in the outcome would most effectively represent the class). Congress endorsed this consensus when it enacted the Private Securities Litigation Reform Act of 1995. Under this Act, the plaintiff with the largest financial interest is the presumptively adequate named plaintiff and is entitled to select counsel for the class. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I) (1997). The Court believes that this provides persuasive authority for the instant issue.

[11] Defendants cite this Court's opinion in *Ford v. NYLcare Health Plans of the Gulf Coast, Inc.,* 190 F.R.D. 422 (S.D. Tex. 1999), as an alleged prohibition against the certification of non-"negative value" cases. However, the opinion simply states, "this suit cannot be classified

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be expected to, put up a genuine fight as required by Rule 23(a)(4). *See In re Workers' Comp.,* 130 F.R.D. at 107; *see also Roper v. Consurve, Inc.,* 578 F.2d 1106, 1112 (5th Cir. 1978).

Defendants argue that Wall Street's decision to only assert a RICO claim will preclude absent class members from asserting other claims, thus creating an intraclass conflict.[12] The Supreme Court has recognized, however, that judgments on classwide claims do not prevent class members from subsequently asserting individual claims based on omitted legal theories. *Cooper v. Fed. Reserve Bank of Richmond,* 467 U.S. 867, 878-81 (1984) (adverse judgment in a Title VII class action did not preclude plaintiffs from bringing individual suits). Moreover, because this is a Rule 23(b)(3) class, dissatisfied class members can opt out of the class. *See* FED. R. CIV. P. 23(c)(2); *Bertulli,* 242 F.3d at 298; *Jenkins,* 782 F.2d at 472 n.5. Accordingly, Wall Street's choice to pursue this case under RICO does not create an intraclass conflict. "[O]nly a conflict which goes to the very subject matter of the litigation will defeat a party's claim to representative status. . . ." *Jenson v. Cont'l Fin. Corp.,* 404 F. Supp. 806, 811 (D. Minn. 1975). There is no such conflict here. The Court is satisfied that Wall Street understands its duty as

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as a 'negative value suit.'" *Id.* at 427. The opinion does not state that the "negative value" claim must be that of the named plaintiff. For some policyholders, with claims measuring but a few hundred or thousand dollars, this case presents just such a negative value case.

[12] Defendants also argue that a class representative who exposes class members to compulsory counterclaims is not an adequate representative. The compulsory counterclaim issue is addressed in Section IV(B)(4)(c) *infra.*

a named plaintiff to act for the benefit of the class. Wall Street has thus met its burden of demonstrating that it will fairly and adequately protect the interests of the proposed class. *See* FED. R. Civ. P. 23(a)(4).

Given the foregoing, the Court determines that Wall Street has met its initial burden of establishing the Rule 23(a) requirements for class certification. The Court thus turns to the question of whether the class is maintainable pursuant to Rule 23(b)(3).

B. Rule 23(b)(3)

Rule 23(b)(3) provides that a class action may be maintained if the Rule 23(a) factors are met and "the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy." FED. R. Civ. P. 23(b)(3). The district court should consider the following factors in making its predominance and superiority determination under Rule 23(b)(3):

(1) the interest of members of the class in individually controlling the prosecution or defense of separate actions;

(2) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class;

(3) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(4) the difficulties likely to be encountered in the management of a class action.

FED. R. Civ. P. 23(b)(3)(A)-(D). In making this determination, the district court must consider variations in state law and must also address how a trial on the merits would be conducted. *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 740 (5th Cir. 1996).

1. Individual Control over Litigation

The first factor, the interest of class members to control litigation individually, matters mainly when absent class members have personal injury claims. *See Georgine v. Amchem Prods., Inc.*, 83 F.3d 610 (3rd Cir. 1996), *aff'd sub nom. Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997). When only economic losses are at issue, this interest to personally control the litigation is small. In a commercial case where class members are companies, economic motivations and interests are paramount. As long as the named plaintiff seeks to maximize the recovery, little else matters. Companies with large claims that wish to preserve control may opt out. Wall Street argues that the class members' interest in individually controlling the prosecution of this litigation is minimal. The Court agrees and therefore turns to the remaining factors.

2. & 3. Other Litigation & Concentration in this Forum

Wall Street contends that the second and third factors – pendency of other litigation and the desirability of concentrating litigation in this forum – also weigh in favor of certification. Although other lawsuits are pending, the instant case is the first to rely on RICO as the major cause

of action. Further, the number of policyholders that have filed individual complaints is small in comparison to the total size of the proposed class. The only case that competes with this lawsuit is a case filed by approximately sixty plaintiffs in Arizona state court. The Arizona suit, however, is not a federal RICO case, does not purport to be a class action, and does not allege a conspiracy. The relative dearth of similar RICO litigation in other courts is further evidence that class members will not individually pursue most claims. The Court also notes that, despite the incentive of treble damages and attorneys' fees available under RICO, the cost of investigating and trying these cases individually likely exceeds the alleged overcharges that policyholders paid Defendants. Furthermore, the value of concentrating litigation in this forum is particularly great because the substantive issues in this lawsuit are complicated, and this Court has already made multiple rulings on this case thus far. Accordingly, the second and third factors weigh in favor of finding predominance and superiority.

4. Manageability

The fourth factor addresses the difficulties likely to be encountered in the management of a class action. Defendants raise numerous arguments relating to the manageability inquiry, including: (a) variations in state law adversely affect predominance and superiority, (b) proximate cause and injury require individualized proof, thus making a trial unmanageable, (c) counterclaims for undercharges against absent class members preclude certification, (d) materiality is not a common issue, (e) defenses defeat predominance, and (f) arbitration clauses defeat

predominance. As discussed below, the Court is unpersuaded by these arguments.

a. Variations in State Laws / *Castano*

Although RICO is the sole issue that will be placed before the jury, Defendants assert that whether the insurance charges are in fact illegal would embroil the Court in the interpretation and application of the laws of approximately forty-five jurisdictions. This, they argue, demonstrates the predominance of individual issues which proscribe class treatment in light of *Castano v. American Tobacco Co.*, 84 F.3d 734 (5th Cir. 1996).

Castano is distinguishable from the instant dispute and does not prohibit certification in these circumstances. First, *Castano* was a personal injury suit alleging numerous common law causes of action.[13] Here, a single law – the federal RICO statute – is the source of Defendants' liability. Second, in *Castano,* the plaintiffs asked the court to apply conflicting state law on the liability issues of negligence and fraud. *Id.* at 741. In this case, while it is true that there is no fraud unless Defendants did, in fact, inflate the filed rate, each jurisdiction implicated by Wall Street's complaint requires Defendants to file their rates

[13] *Castano* was a suit filed on behalf of all smokers and nicotine dependent persons against numerous tobacco companies and The Tobacco Institute. *Castano,* 84 F.3d at 737. The plaintiffs' causes of action included: fraud and deceit, negligent misrepresentation, intentional infliction of emotional distress, negligence and negligent infliction of emotional distress, violation of state consumer protection statutes, breach of express and implied warranty, strict products liability, and redhibition [sic]. *Id.*

and rating plans for workers' compensation coverage and adhere to them.[14] Wall Street's RICO claim seeks to enforce these filed rates. In denying Defendants' motion for summary judgment, this Court previously held that "[a]pplication of RICO in this case does not directly conflict

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[14] *See* ALA. CODE §§ 27-13-67 & 27-13-68, § 25-5-8 (1986); ALASKA STAT. § 21.39.040 (Michie 1998); ARIZ. REV. STAT. ANN. § 20-357 (West Supp. 1999); ARK. CODE ANN. § 23-67-219 (Michie Supp. 1997); COLO. REV. STAT. § 10-4-405 (1999); CONN. GEN. STAT. ANN. § 38a-676 (West 1992); DEL. CODE ANN. tit. 18, §§ 2609 & 2610 (1989 & Supp. 1996); D.C. CODE ANN. §§ 35-205 & 35-1704 (1997); FLA. STAT. ANN. §§ 627.091 & 627.062 & 627.101 (West Supp. 2000); GA. CODE ANN. § 33-9-21 (1996); HAW. REV. STAT. ANN. §§ 141:14-120 & 431:14-104 (Michie 1994); IDAHO CODE §§ 41-1606 & 41-1608 & 41-1609 (Michie 1998); 215 ILL. COMP. STAT. ANN. 5/457-458 (Supp.1998); IND. CODE ANN. § 27-1-22-4 & 27-7-2-20.2 (Michie 1997); IOWA CODE ANN. § 515A.4 (West 1998); KAN. STAT. ANN. § 40-955 (Supp. 1999); KY. REV. STAT. ANN. § 304.13-051 (Michie 1996); LA. REV. STAT. ANN. § 22:1407 (West 1998); ME. REV. STAT. ANN. tit. 24-A, § 2382-C (West 2000); MD. CODE ANN., INS. §§ 11-330 & 11-307 & 11-329 (1997); MASS. GEN. LAWS ANN. ch. 152, § 53A (West 1998); MICH. STAT. ANN. §§ 24.12406 & 500.2406 (Michie 1994); MINN. STAT. ANN. §§ 70A.06 & 79.55 & 79.56 (West 1999); MISS. CODE ANN. § 83-2-7 (1999); MO. ANN. STAT. §§ 287.947 & 287.955 & 379.321 (West 1991 & Supp. 2000); MONT. CODE ANN. §§ 33-16-1026 & 33-16-1030 (1999); NEB. REV. STAT. §§ 44-5020 & 44-5028 (1998); NEV. REV. STAT. ANN. § 686B.070 (Michie 1997); N.H. REV. STAT. ANN. § 412:8 (1998); N.M. STAT. ANN. § 59A-17-10 (Michie 1995); N.Y. INS. LAW § 2305 (McKinney 1985 & Supp. 2000); N.C. GEN. STAT. §§ 58-40-30 & 58-36-15 & 58-36-20 (1994 & Supp.1997); OKLA.STAT.ANN. tit. 36, §§ 903 & 901 & 996 & 998 (West 1999); OR. REV. STAT. §§ 737.205 & 737.320 (1995); 40 PA. CONS. STAT. ANN. § 710-5 (West 1999) & 77 PA. CONS. STAT. ANN. § 1035.5 (West 1999); R.I. GEN. LAWS §§ 27-7.1-2 & 27-7.5-5.1 & 27-44-6 (1998); S.C.Code Ann. §§ 38-73- 340 & 38-73-490 & 38-73-520 (Law.Co-op.1989); S.D. CODIFIED LAWS § 58-24-10 (Michie 1996); TENN. CODE ANN. § 56-5-306 (1994); TEX. INS. CODE ANN. § 5.55 (Vernon 1999); UTAH CODE ANN. §§ 31A-21-201 & 31A-19-408 (1999); VT. STAT. ANN. tit. 8, §§ 4687 & 4688 (1993); VA. CODE ANN. §§ 38.2-1906 & 38.2-2003 (Michie 1999); WASH. REV. CODE ANN. § 48.19.040 (West 1999); WIS. STAT. ANN. § 626.13 (West 1995).

with any state regulation, but rather, complements the states' regulations by enforcement." *Sandwich Chef,* 111 F. Supp. 2d at 877. Several of Defendants' witnesses, versed in insurance regulation, were questioned and none could identify any jurisdiction that allowed a carrier to charge an unfiled rate. Thus, Wall Street's RICO claim does not require the Court to apply conflicting state laws.

Moreover, the regulatory purposes for these filing requirements are important to the subject jurisdictions; besides requiring the filing of rates and rating plans, all jurisdictions subject to Wall Street's complaint uniformly require carriers to file all forms that they use in writing workers' compensation coverage.[15] The forty-five

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[15] ALA. CODE § 27-14-8 (1986); ALASKA STAT. § 21.42.120 (Michie 1998); ARIZ. REV. STAT. ANN. § 20-398 (West Supp. 1999); ARK. CODE ANN. § 23-79-109 (Michie Supp. 1997); COLO. REV. STAT. § 10-4-419 (1999); CONN. GEN. STAT. ANN. § 38a-676 (West 1992); DEL. CODE ANN. tit. 18, § 2712 (1989 & Supp. 1996); D.C. CODE ANN. § 35-1531 (1997); FLA. STAT. ANN. § 627.410 (West Supp. 2000); GA. CODE ANN. § 33-24-9 (1996); HAW. REV. STAT. ANN. § 386-124 (Michie 1994); IDAHO CODE § 41-1812 (Michie 1998); 215 ILL. COMP. STAT. ANN. 5/143 (West Supp. 1998); IND. CODE ANN. § 22-3-5-5 (Michie 1997); IOWA CODE ANN. § 515.109 (West 1998); KAN. STAT. ANN. § 40-216 (Supp. 1999); KY. REV. STAT. ANN. § 304.14-120 (Michie 1996); LA. REV. STAT. ANN. § 23:1161 (West 1998); ME. REV. STAT. ANN. tit. 24-A, § 2412 (West 2000); MD. CODE ANN., INS. § 11-206 (1997); MASS. GEN. LAWS ANN. ch. 175, § 2B (West 1998); MICH. STAT. ANN. § 24.12236 (Michie 1994); MINN. STAT. ANN. § 70A.06 (West 1999); MISS. CODE ANN. § 83-2-7 (1999); MO. ANN. STAT. § 379.321 (West 1991 & Supp. 2000); MONT. CODE ANN. § 33-1-501 (1999); NEB. REV. STAT. § 48-146 (1998); NEV. REV. STAT. ANN. § 686B.070 (Michie 1997); N.H. REV. STAT. ANN. § 412:2 (1998); N.M. STAT. ANN. § 59A-18-12 (Michie 1995); N.Y. INS. LAW § 2307 (McKinney 1985 & Supp. 2000); N.C. GEN. STAT. §§ 58-36-55 & -41-50 (1994 & Supp. 1997); OKLA. STAT. ANN. tit. 36, § 3610 (West 1999); OR. REV. STAT. § 737.265 (1995); 40 PA. CONS. STAT. ANN. § 477b (West 1999); R.I. GEN. LAWS § 27-7.1-2 (1998); S.C. CODE ANN. § 38-61-10 (Law.

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jurisdictions that authorized Option V coverage have adopted the same policy and set of mandatory endorsements, the WC 00 05 series endorsements. By definition, all policies within the class have one of these WC 00 05 endorsements that allows Defendants to write Option V workers' compensation coverage risk in several jurisdictions under one policy. Therefore, not only are the regulations of the jurisdictions that underlie Wall Street's RICO claim uniform in all material ways, but the contract language that binds the policyholders and Defendants is also the same.[16]

Finally, minor variations in state laws, e.g., numerical differences among state rates, do not prevent certification. Other federal courts have certified nationwide class actions in cases where the existence of RICO liability depended in one way or another on state laws or state imposed fees that varied from place to place.[17]

Co-op. 1989); S.D. CODIFIED LAWS § 58-11-12 (Michie 1996); TENN. CODE ANN. § 56-5-306 (1994); TEX. INS. CODE ANN. § 5.35 (Vernon 1999); UTAH CODE ANN. § 31A-21-201 (1999); VT. STAT. ANN. tit. 8, § 4201 (1993); VA. CODE ANN. § 38.2-2014 (Michie 1999); WASH. REV. CODE ANN. § 48.18.100 (West 1999); WIS. STAT. ANN. § 631.20 (West 1995); *see also Wal-Mart Stores, Inc. v. Crist,* 855 F.2d 1326, 1333 (8th Cir. 1988) ("all states . . . require that insurers file their . . . policy forms for review by state authorities").

[16] Although some premium factors for Option V policies are negotiable, tax multipliers and residual market subsidies are fixed by law. Wall Street only complains about the deviations from these fixed rates, not negotiable rates.

[17] *See In re Consol. "Non-Filing Ins." Fee Litig.,* 195 F.R.D. 684 (M.D. Ala. 2000) (nationwide class where damages depended upon varying state UCC-1 filing fees); *Sikes v. AT&T,* 179 F.R.D. 342 (S.D. Ga. 1998) (certifying a nationwide class alleging RICO violations in connection with telephone gambling game, where the occurrence of a

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Wall Street has demonstrated, by calculating its own proper rates and by identifying the computer databases possessed by NCCI and Defendants, that it is an administrative matter to apply the proper rates to class members' coverages. Unlike the situation in *Castano,* variations in state law will not "swamp" the Court in the instant case.

b. Proximate Cause & Injury

(1) Under *Summit Properties Inc. v. Hoechst Celanese Corp.,* Wall Street may establish proximate cause by either the "target wing" or "reliance wing."

Defendants argue that a trial of class claims is impossible due to the predominance of individualized issues. RICO's language that a person be "injured in his business or property by reason of a violation of 1962" requires both "but for" and "proximate" causation. *Holmes v. Sec. Investor Prot. Corp.,* 503 U.S. 258, 265-66 (1992). The Fifth Circuit discussed these causation requirements in *Summit Properties Inc. v. Hoechst Celanese Corp.,* 214 F.3d 556, 558-61 (5th Cir. 2000).

Under *Summit,* proximate cause in a RICO fraud case is established if the plaintiff "has *either* been the target of a fraud ["target wing"] *or* has relied upon the fraudulent conduct of defendants ["reliance wing"]." *Summit,* 214 F.3d at 561 (emphasis added). The Fifth Circuit recently reaffirmed the independence of the target wing of *Summit,* stating that a third party's reliance upon a fraudulent

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violation turned on whether the game violated the gambling laws of the states where it was played).

statement can serve to establish proximate cause where it causes injury to the plaintiff. *Procter & Gamble Co. v. Amway Corp.*, 242 F.3d 539, 564-65 (5th Cir. 2001) (reversing the dismissal of a RICO claim where Procter & Gamble alleged injury because its customers relied on defendants' misrepresentations). Here, Wall Street has stated a claim under both the target and reliance wings of *Summit*.

(a) "Target Wing" (Fraud-on-the-Regulator Theory)

Under the target wing of *Summit*, reliance by the class members is not an issue. *See Procter & Gamble*, 242 F.3d at 565. Reliance upon a fraudulent representation or omission by a third person – here, regulators – is sufficient to state a RICO claim if the plaintiff is injured as a result. *Id.; see also Shaw v. Rolex Watch, U.S.A., Inc.*, 726 F.Supp. 969, 972-73 (S.D.N.Y. 1989) (plaintiff injured by defendant's deceit of the U.S. Customs Department).[18] Thus, Wall Street may establish proximate cause by establishing

[18] Other circuits have accepted the target analysis, particularly where a fraud is perpetrated on a regulator for the purpose of defrauding a protected class. *See, e.g., Rodriguez v. McKinney*, 156 F.R.D. 112 (E.D. Pa. 1994) (certifying class of vocational school students where defendant misrepresented the ability of the students to benefit from the program to the Department of Education); *see also United States v. Cavin*, 39 F.3d 1299 (5th Cir. 1994) (defendant defrauded Alliance policyholders by misrepresentations to the Commissioner of Insurance); *Learjet Corp. v. Spenlinhauer*, 901 F.2d 198 (1st Cir. 1990) (buyer of airplane defrauded by aircraft manufacturer's misrepresentations to the Federal Aviation Administration); *United States v. Olatunji,*, 872 F.2d 1161, 1167 (3rd Cir. 1989) (Department of Education defrauded by defendants' false statements to the Immigration and Naturalization Services).

that the class members were injured by the regulators' reliance on Defendants' misrepresentations and omissions.

This Court previously analyzed the issue of proximate cause and concluded that, under the "target wing" of the Fifth Circuit's decision in *Summit,* Wall Street's "allegations of fraud, through the scheme to collect excessive workers' compensation premiums, [are] sufficient to satisfy RICO after *Summit.*" *Sandwich Chef,* 111 F. Supp.2d at 876 ("Wall Street's fraud-on-the-regulator [theory] is cognizable as a RICO claim after *Summit* because Wall Street has established through the summary judgment evidence that the defendants engaged in a scheme to collect phantom premiums through misrepresentations made to insurance regulators.").

As argued by Wall Street, evidence at the certification hearing provided further details of the foundation for Wall Street's fraud-on-the-regulator allegations. When NCCI made its R-1244 filing (seeking authority for residual market subsidies in filed rates), it represented that the costs of the residual market pools were not currently considered in Defendants' filed rates. The filing concealed that many Defendants were already charging these costs to policyholders. R-1244 also stated that Defendants intended only a "partial pass-through" of these costs when representatives of several Defendants testified that, at the time, they intended to, and did, charge their policyholders a full pass-through. Wall Street alleges that R-1244, at best, was a representation that was a half-truth, intended to mislead regulators and furthered Defendants' overcharge scheme by concealing material facts from state

regulators.[19] In addition to NCCI's misrepresentations and omissions, Wall Street contends that individual Defendants made similar deceitful representations directly to regulators.

According to Wall Street, the alleged purpose of the fraudulent filings was to mislead regulators to believe that Defendants were complying with the filed rates. Wall Street asserts that the filings, both for the overall plan rates and the individual policyholders plan rates, failed to disclose that Defendants would charge additional unfiled charges; moreover, the overall plan rate filings, such as R-1244, falsely stated or implied to regulators that Defendants intended to comply with the filed rates.

Despite the foregoing analysis, Defendants argue that the necessity of showing injury through individual proof defeats class certification. The Court disagrees. Under the target wing, Wall Street may first show that the regulators relied upon the filings and would have enforced the filed rates. Defendants have not argued that regulators failed to enforce the filed rates. The alleged conduct of Defendants, if proved, would show that they understood it was necessary to conceal their actual charges by making deceitful filings in violation of state laws.[20] The impact of

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[19] *See* FIFTH CIRCUIT PATTERN JURY INSTRUCTIONS, CIVIL 8.1 at 85 (West 1999) ("A statement or representation may also be 'false' or 'fraudulent' if it constitutes a half truth, or effectively conceals a material fact, with the intent to defraud.")

[20] All jurisdictions prohibit Defendants from making false or misleading filings or other statements to state regulators. ALA. CODE § 27-13-77 (1986); ALASKA STAT. § 21.39.140 (Michie 1998); ARIZ. REV. STAT. ANN. § 20-372 (West Supp. 1999); COLO. REV. STAT. § 10-4-417 (1999); CONN. GEN. STAT. ANN. § 38a-679 (West 1992); DEL. CODE ANN.

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Defendants' alleged scheme therefore affects all class members the same.

The "target wing" claim based on Wall Street's fraud-on-the-regulator theory is a common issue faced by all class members that may be proved or disproved at trial from a common set of facts under a single federal law. The Court thus finds that Wall Street has established predominance and superiority for its "target wing" claim.

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tit. 18, § 2528 (1989 & Supp. 1996); D.C. CODE ANN. § 22-3825.2 (1997); FLA. STAT. ANN. § 627.361 (West Supp. 2000); GA. CODE ANN. § 33-9-35 (1996); HAW. REV. STAT. ANN. § 431:14-115 (Michie 1994); IDAHO CODE § 41-1431 (Michie 1998); 215 ILL. COMP. STAT. ANN. 5/467 (West Supp. 1998); IND. CODE ANN. § 27-1-22-17 (Michie 1997); IOWA CODE ANN. § 515A.14 (West 1998); KAN. STAT. ANN. § 40-1119 (Supp. 1999); KY. REV. STAT. ANN. § 304.47-020 (Michie 1996); LA. REV. STAT. ANN. § 22:1416 (West 1998); ME. REV. STAT. ANN. tit. 24-A, § 2326 (West 2000); MD. CODE ANN., INS. § 11-231 (1997); MASS. GEN. LAWS ANN. ch. 174A, § 16 (West 1998); MICH. STAT. ANN. § 500.2474 (Michie 1994); MINN. STAT. ANN. § 70A.20 (West 1999); MISS. CODE ANN. §§ 83-5-35 & 85-5-67 (1999); MO. ANN. STAT. § 379.353 (West 1991 & Supp. 2000); MONT. CODE ANN. § 33-16-107 (1999); NEB. REV. STAT. § 44-5034 (1998); NEV. REV. STAT. ANN. § 686B.1797 (Michie 1997); N.H. REV. STAT. ANN. § 413:8 (1998); N.M. STAT. ANN. § 59A-17-31 (Michie 1995); N.Y. INS. LAW § 2315 (McKinney 1985 & Supp. 2000); N.C. GEN. STAT. § 58-40-45 (1994 & Supp. 1997); OKLA. STAT. ANN. tit. 36, § 935 (West 1999); OR. REV. STAT. § 737.535 (1995); 40 PA. CONS. STAT. ANN. § 1194 (West 1999); R.I. GEN. LAWS § 27-6-45 (1998); S.C. CODE ANN. § 38-73-80 (Law. Co-op. 1989); S.D. CODIFIED LAWS § 58-24-34 (Michie 1996); TENN.CODE ANN. § 56-47-104 (1994); TEX. INS. CODE ANN. § 5.21 (Vernon 1999); UTAH CODE ANN. § 31A-19a-215 (1999); VT. STAT. ANN. tit. 8, § 4724 (1993); VA. CODE ANN. § 38.2-1927 (Michie 1999); WASH. REV. CODE ANN. § 48.19.390 (West 1999); WIS. STAT. ANN. § 895.486 (West 1995).

(b) "Reliance Wing" (Invoice Theory)

The next issue is whether Wall Street can prove proximate cause under *Summit's* reliance wing for its invoice theory without requiring individualized proof of reliance. Under Rule 23(b)(3), district courts must examine questions of individualized proof in light of the elements of the cause of action and the applicable defenses. *Patterson v. Mobil Oil Corp.*, 241 F.3d 417, 419 (5th Cir. 2001); *Bolin v. Sears, Roebuck & Co.*, 231 F.3d 970, 976 (5th Cir. 2000).

The Fifth Circuit has overruled orders certifying (b)(3) classes in cases where the facts required individual proof of reliance that would "defeat the economics ordinarily associated with the class action device." *Patterson,* 241 F.3d at 419; *see also Bolin,* 231 F.3d at 978;[21] *Castano,* 84 F.3d at 745. The proposed classes in *Castano, Bolin* and *Patterson* were unsuitable for certification due to the multiplicity of individual issues presented by each claimant. *Castano* involved mass tort claims for personal injuries, economic losses, emotional distress, and wanton or reckless conduct under the varying laws of the fifty states. *Castano,* 84 F.3d at 734. *Bolin* involved "holistic" certification of numerous claims for consequential losses incurred as a result of the defendant's alleged illegal

[21] In *Bolin,* the Fifth Circuit's statement regarding (b)(3) certification was not dispositive of the case, as only (b)(2) certification was before the court. The Fifth Circuit appears to have adopted the (b)(3) ruling, however, by its statement in *Patterson. See Patterson,* 241 F.3d at 419 (stating that "[in *Bolin*], we held that 'the individual findings of reliance necessary to establish RICO liability and damages preclude not only (b)(2) certification of this class under RICO, but (b)(3) certification as well' ").

collection practices, such as hiring attorneys to defend litigation brought by the defendant. *Bolin,* 231 F.3d at 978. In *Patterson,* to establish reliance "each plaintiff would have to make an individual showing that she could have and would have sued Mobil, but did not do so because the asserted false statements led her to believe her suit to be barred by the workers' compensation regime." *Patterson,* 241 F.3d at 419.

Wall Street's invoice theory claim is simple in contrast to the claims pursued in *Patterson, Bolin* and *Castano*; moreover, its claim has not been directly addressed by the Fifth Circuit. Wall Street's claim concerns only direct, not consequential, economic injury for conduct that falls within RICO's statute of limitations. The injury to each class member is the same: an alleged overcharge resulting from an inflated invoice. Everything needed to measure the injury for the class, as well as for each class member, can be found in Defendants' records. Wall Street's invoice theory claim thus does not raise the many complicating factors that have defeated Rule 23(b)(3) certification in other cases.[22]

Further, Wall Street's invoice theory claim alleges only one type of direct misrepresentation by Defendants to the

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[22] Furthermore, as addressed in the parties' pleadings and by Wall Street during the class certification hearing, several of the Defendants in the instant action were defendants in *Weatherford Roofing Co. v. Employers National Insurance Co.,* Cause No. 91-05637-F, in the 116th Judicial District Court of Dallas County, Texas. *Weatherford* was similar to the instant suit, in that it alleged that insurance carriers charged policyholders higher than approved rates for retrospectively rated workers' compensation insurance. The case settled on a class basis with court approval.

policyholders: written invoices.[23] Wall Street contends that Defendants inflated their invoices pursuant to the scheme. Wall Street argues that each invoice containing phantom premiums (overcharges) was an affirmative misrepresentation of the amount lawfully due. Wall Street believes that the invoices failed to disclose that Defendants had not made the necessary filings to allow the deviant charges. Absent such filings, Defendants could not lawfully charge the amount invoiced.

Wall Street also submits that these invoices constitute classic mail fraud.[24] Wall Street asserts that, pursuant to the filed rate doctrine, the policyholder did not owe more than the filed rate at the time the invoices were sent. Wall Street also presented evidence that Defendants knowingly sent policyholders invoices that Defendants knew were higher than the filed rates at the time the invoices were sent and that these practices were established in Defendants' manuals.

The Fifth Circuit has *not* held that a RICO fraud class action may never be maintained under Rule 23(b)(3). A holding that a RICO fraud class action may never be maintained would be contrary to the Supreme Court's observation in *Amchem* that class action requirements are

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[23] The complaint alleges no oral misrepresentations, which distinguishes this case from those cited by Defendants for the proposition that individualized proof of fraud is necessary.

[24] The fraud element for mail fraud involves a violation of "fundamental honesty, fair play and right dealing." *Gregory v. United States*, 253 F.2d 104, 109 (5th Cir. 1958).

"readily met in certain cases alleging consumer or securities fraud." *Amchem,* 521 U.S. at 625.[25]

Furthermore, class certification is particularly appropriate when purchasers seek redress for widespread commercial abuses. *Alabama v. Blue Bird Body Co., Inc.,* 573 F.2d 309, 320 (5th Cir. 1978) (price-fixing conspiracies "are particularly suited for class action treatment"). In this case, individualized proof of reliance is not an obstacle to class certification because the act of payment of invoices may establish circumstantial evidence of reliance.[26]

In a RICO fraud case alleging overcharges, proximate cause (reliance and injury) can be proved by circumstantial evidence of the transaction that resulted in the overcharge. In *Chisolm v. TranSouth Financial Corp.,* 194 F.R.D. 538, 567 (E.D. Va. 2000), the district court held that payments of excessive charges themselves proved detrimental reliance. *Chisolm,* 194 F.R.D. at 560 (citing *Chevalier v. Baird Sav. Ass'n,* 72 F.R.D. 140, 149 (E.D. Pa. 1976)

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[25] The Court also notes that other district courts have allowed class actions to proceed on claims that require proof of reliance. *See In re Consol. "Non-Filing Ins." Fee Litig.,* 195 F.R.D. 684, 692 (M.D. Ala. 2000); *Chisolm v. TransSouth Fin. Corp.,* 194 F.R.D. 538, 567 (E.D. Va. 2000); *Sikes v. AT & T,* 179 F.R.D. 342, 356 (S.D. Ga. 1998); *Rodriguez v. McKinney,* 156 F.R.D. 112, 118 (E.D. Pa. 1994).

[26] The Court declines to adopt Wall Street's alternative methods of proving reliance – i.e., "presumed reliance" and "the *Ute* presumption" based upon *Affiliated Ute Citizens v. United States,* 406 U.S. 128 (1972). *See, e.g., Chisolm,* 194 F.R.D. at 560 n.24 (noting that presumed reliance is generally disfavored in civil RICO); *see also Buford v. H & R Block, Inc.,* 168 F.R.D. at 359 n.8 (determining that *Ute* reliance does not reach beyond § 10b-5 actions); *cf. Perrone v. Gen. Motors Acceptance Corp.,* 232 F.3d 433, 439 (5th Cir. 2000) (rejecting the *Ute* presumption in TILA case.

(payment of excessive interest charges was sufficient to show Sherman Act impact)). Here, Wall Street argues that the circumstances in the instant case compel a finding of reliance by means of circumstantial evidence – namely, proof that the invoices contained material misrepresentations (i.e., inflated premiums) and that the class members paid overcharges in reliance upon such invoices.

Defendants challenge that *Chisolm* is predicated upon the "fraud on the market" theory that the Fifth Circuit rejected in *Summit.* However, while *Chisolm* mentioned the fraud on the market theory, it did not rely on it. *Chisolm,* 194 F.R.D. at 560. The *Chisolm* court acknowledged that "[p]resumed reliance under civil RICO is generally disfavored outside of certain narrow contexts." *Id.* The court noted that it was not presuming reliance, but was instead concluding that reliance was proved for all class members by circumstantial proof. *Id.* at n.24 (quoting *Todd v. Sykes,* 33 S.E. 517, 519 (Va. 1899) ("A transaction may itself and by itself furnish the most satisfactory proof of fraud, so conclusive as to outweigh the answer of the defendant and even the evidence of witnesses.")). Given the conduct at issue in *Chisolm,* the court held that no reasonable person could conclude other than that the class members relied upon the invoices by paying them. *Id.* at 561-62.

The use of circumstantial evidence to prove reliance is well-established. *Vasquez v. Superior Court,* 484 P.2d 964, 972 (Cal. 1971) (observing the rule in California "and elsewhere that it is not necessary to show reliance upon false representations by direct evidence"). "Circumstantial evidence [of reliance under common law fraud] is not only sufficient, but in most cases it is the only proof that can be adduced." *Cook v. Hayden,* 31 S.E.2d 625 (Va. 1944).

Indeed, inferences from circumstances surrounding a transaction may be stronger and more satisfactory evidence than direct testimony. *Vasquez,* 484 P.2d at 972. "[I]f . . . the trial court finds misrepresentations were made to the class members, at least an inference of reliance would arise as to the entire class." *Id.* at 973.

In addition to *Chisolm* and *Vasquez,* the Northern District of Texas recently relied on *Vasquez* and applied its reasoning. *See In re Great S. Life Ins. Co. Sales Practices Litig.,* 192 F.R.D. 212, 220 (N.D. Tex. 2000). While recognizing that *Vasquez* applied to misrepresentations, the district court applied its rationale to omissions. *Id.* Here, Wall Street has pleaded that class members were presented invoices with inflated premiums that constitute misrepresentations, omissions or both. Wall Street alleges that the invoices were material and that, in reliance upon these invoices, the class members paid overcharges. Based on *Chisolm, Vasquez* and *In re Great Southern,* the Court determines that Wall Street and the class are entitled to use the invoices and payment of the invoices as circumstantial evidence of detrimental reliance.[27] Furthermore, Wall Street may present expert witness testimony that businesses customarily and reasonably rely on the accuracy of invoices, especially invoices sent by regulated entities, and that commercial transactions between

[27] Defendants assert that the Fifth Circuit in *Patterson* rejected reliance based on circumstantial evidence of the conduct of class members. *Patterson,* however, neither addresses nor rejects *Chisolm* or the use of circumstantial evidence of reliance.

businesses occur based on an ethic of honesty and fair dealing.[28]

c. Counterclaim Issue

Defendants further argue that the class should not be certified because absent class members will be subject to compulsory counterclaims arising from alleged undercharges. Defendants contend that they undercharged many putative class members for workers' compensation insurance and provided these members with financial benefits that differed from, and were in addition to, the benefits provided under filed rate programs. Defendants argue that the employers and insurers engaged in highly customized and individually negotiated transactions, underscoring the need for individualized adjudications involving multiple state laws. Defendants state that these circumstances evidence incurable conflicts between Wall Street and its putative class members who will be exposed to significant counterclaims from their insurers. The parties provided additional briefing on this issue which the Court has reviewed. Having considered the impact of such threatened counterclaims on certification, *see George v. Beneficial Fin. Co. of Dallas,* 81 F.R.D. 4, 6-7 (N.D. Tex. 1977), the Court determines that the counterclaim issue does not bar certification under these circumstances.

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[28] *See Rodriguez,* 156 F.R.D. at 117 (plaintiff may "use expert testimony to develop the inference that a student otherwise unable to afford an education is induced to enroll in school by being offered a student loan").

As an initial matter, Defendants' threats of undercharge counterclaims against absent class members are properly characterized as speculative. Approximately one month before the class certification hearing, Defendant Reliance filed its counterclaim against Wall Street. The counterclaim asserts a cause of action for breach of contract based upon Wall Street's alleged failure to pay workers' compensation premiums, as well as automobile and general liability insurance premiums.[29] However, the breach of contract counterclaim – based upon nonpayment of insurance premiums – is hardly the same as Defendants' threats of counterclaims based upon alleged *undercharges.* Defendants argue that they are entitled to undercharges from absent class members because the insureds financially benefitted from negotiated insurance programs; yet Reliance's actual, pending counterclaim against the only named plaintiff is devoid of any cause of action based upon such undercharges.[30]

Furthermore, because absent class members are not "parties," they are not subject to compulsory counterclaims. *See Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 810 (1985) ("absent plaintiff class members are almost never subject to counterclaims or cross-claims, or liability

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[29] By Order entered on the same date as this opinion, the Court has severed Defendant Reliance's automobile and general liability insurance premium counterclaim from this action. The workers' compensation premium counterclaim remains in the suit.

[30] In its recitation of facts in its first amended counterclaim, Reliance asserts that Wall Street "benefitted substantially from the insurance coverage provided by Reliance." However, its breach of contract claim relies solely upon Wall Street's alleged failure to pay premiums.

for fees or costs"); *Transamerican Refining Corp. v. Dravo Corp.*, 139 F.R.D. 619, 621 (S.D. Tex. 1991) ("absent class members are not parties within the meaning of Rule 23"); *see also Buford v. H & R Block, Inc.*, 168 F.R.D. 340, 363-64 (S.D. Ga. 1996); *see generally* 1 HERBERT B. NEWBERG AND ALBA CONTE, NEWBERG ON CLASS ACTIONS § 4.34 (3d ed. 1992 & Supp. 2001).[31]

As the Fifth Circuit stated in *Roper v. Consurve, Inc.*, "potential assertion of counter claims against these few members of the proposed class cannot be allowed to defeat an otherwise valid class action when to do so would effectively deprive thousands of class members of the relief to which they are entitled." *Roper v. Consurve, Inc.*, 578 F.2d 1106, 1116 (5th Cir. 1978), *aff'd on other grounds*, 445 U.S. 326 (1980). Here, Defendants' speculative undercharge counterclaims do not constitute a legitimate bar to certification, based on the Fifth Circuit's statement in *Roper*. *See id.*

Moreover, the counterclaim issue does not make the case unmanageable at trial. First, Wall Street's Trial Plan addresses and manages the counterclaim issue.[32] Second,

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[31] Defendants argue that *Heaven v. Trust Co. Bank*, 118 F.3d 735 (11th Cir. 1997), supports denial of certification on this issue. *Heaven* is distinguishable from the instant case because the plaintiff, asserting a TILA claim, conceded that a debt counterclaim was in fact a compulsory counterclaim under existing law. *Heaven*, 118 F.3d at 737. There is clearly no such concession by Wall Street in this case. In fact, Wall Street questions whether an undercharge counterclaim will be asserted; to date, none has been filed. Wall Street also correctly points out that *Heaven* did not address the issue of whether unnamed class members are "opposing parties." *See Selby v. Principal Mut. Life Ins. Co.*, No. 98 CIV 5283, 2000 WL 1863760, at *7 (S.D. N.Y. Dec. 20, 2000).

[32] *See* Section II(B) (Phase 1) (Step 6) *supra*.

the Court has the authority to sever such counterclaims, if they arise. Third, jury instructions may be crafted so as to eliminate juror confusion regarding the effect of such counterclaims. Accordingly, the Court determines that Defendants' allegations of potential counterclaims do not bar certification in this case.

d. Materiality

Defendants suggest that Wall Street cannot establish materiality of the invoices sent to policyholders on a class-wide basis. Invoices that charge phantom premiums are material if a reasonable person would attach importance to them. *See* RESTATEMENT (SECOND) OF TORTS § 538(2)(a) (1976).[33] Because this standard is an objective one, there is no need for individual evidence from policyholders as to whether they found the inflated bill to be material. The jury need only decide if a reasonable business would attach importance to such invoices. "The law is well settled that materiality can be proven class wide." *Waters v. Int'l Precious Metals Corp.*, 172 F.R.D. 479, 503 (S.D. Fla. 1996). The Court therefore finds that materiality is a common issue that predominates in this case.

[33] This section of the RESTATEMENT was quoted by the Supreme Court in defining "materiality" in the federal mail fraud statute. *Neder*, 527 U.S. at 22 n.5. The Court further held that "a false statement is material if it has a natural tendency to influence, or [is] capable of influencing the decision of the decision making body to which it was addressed." *Id.* at 16 (quoting *Kungys v. United States*, 485 U.S. 759, 770 (1988)).

e. Defenses

Defendants also argue that their defenses bar certification. First, Defendants argue that the statute of limitations creates individual issues. The Court disagrees. The start date for Wall Street's class excludes policies closed by a final premium adjustment beyond the statute of limitations. In *Love v. National Medical Enterprises,* 230 F.3d 765 (5th Cir. 2000), the Fifth Circuit adopted the "separate accrual" rule, wherein every fraudulent invoice mailed within four years of the filing of Wall Street's original complaint is a separate injury within the limitations period. *See Love,* 230 F.3d at 774-75. Therefore, the statute of limitations defense does not preclude certification of this class.

Defendants also assert that the equitable defense of *in pari delicto,* pursuant to the formulation set forth in *Bateman Eichler, Hill Richards, Inc. v. Berner,* 472 U.S. 299 (1985), presents individual issues that prevent certification. Under the *Bateman Eichler* test:

> [A] private action for damages . . . may be barred on the grounds of the plaintiff's own culpability only where (1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.

472 U.S. at 310-11. The *Bateman Eichler* test has been applied to RICO claims. *Florida Software Sys. v. Columbia/HCA Healthcare Corp.,* No. 97-2866-Civ-T-17B, 1999 WL 781812, at *2 (M.D. Fla. 1999); *Bieter v. Blomquist,* 848 F. Supp. 1446, 1449 (D. Minn. 1994).

"Plaintiffs who are truly *in pari delicto* are those who have themselves violated the law in cooperation with the defendant." *E.g., Pinter v. Dahl,* 486 U.S. 622, 636 (1988) (internal quotations omitted). "Unless the degrees of fault are essentially indistinguishable or the plaintiff's responsibility is clearly greater, the *in pari delicto* defense should not be allowed, and the plaintiff should be compensated." *Id.*

The RICO cases addressing *in pari delicto* arise from allegations that the plaintiff was involved in the racketeering conduct. *See, e.g., id.* No evidence of any class member's involvement in the alleged scheme was presented to this Court in the certification hearing. Defendants do not argue that any class member participated in the alleged scheme to corrupt NCCI, to make false rate filings, or to prepare deceitful invoices. Accordingly, the *in pari delicto* defense does not prohibit certification.

f. Arbitration Agreements

Defendants argue that class certification is improper because some class members have arbitration agreements with some Defendants. Wall Street is the only party to this proceeding. Its policies with Reliance do not contain arbitration clauses; further, no arbitration agreements exist between Wall Street and other carriers.

Additionally, Defendants' arbitration agreements are not filed in any jurisdiction for use with workers' compensation insurance. More importantly, these agreements were not made part of any policy by endorsement. The merger clause of the filed policy, eliminating any agreement not endorsed to the policy,

renders the arbitration agreement immaterial to the determination of premiums.

Moreover, it is questionable whether Defendants can invoke the Federal Arbitration Act ("FAA") to enforce the arbitration agreements controlling workers' compensation premiums. The McCarran-Ferguson Act preempts federal laws that may invalidate, impair or supersede the states' regulation of the business of insurance. 15 U.S.C. § 1012(b) (1994). Because the states regulate workers' compensation premiums through filed rates and forms, the use of these agreements may "invalidate, impair or supersede" the regulation of insurance. Courts have not hesitated to preempt the FAA when it impairs state law regulating insurance.[34] One federal district court has expressed concern about whether Defendant Home Insurance Company's arbitration agreement could be allowed to supersede the terms contained in the approved policy.[35]

Finally, even if a Defendant validly invokes the arbitration agreements, the agreements will not materially affect the RICO class-wide claims. Nor can an

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[34] *See, e.g., Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277 (10th Cir. 1998) (holding FAA reverse preempted by state statute under McCarran-Ferguson); *Munich Am. Reinsurance Co. v. Crawford*, 141 F.3d 585 (5th Cir. 1998) (holding FAA reverse preempted by state statute under McCarran-Ferguson); *Washburn v. Corcoran*, 643 F. Supp. 554 (S.D.N.Y. 1986) (holding FAA reverse preempted by state statute under McCarran-Ferguson).

[35] *In re Home Indem. Co.*, No. 94 CIV. 3174, 1994 WL 557068, at *1 (S.D.N.Y. Oct. 11, 1994) ("Moreover, it is questionable whether the Arkansas statute would be read to permit its protection of policyholders to be evaded by this stratagem of putting premium provisions in a separate agreement.").

arbitration clause govern any class member's RICO claim against any Defendant other than the carrier that issued its policy. Consequently, arbitration clauses do not provide a basis to prevent Wall Street from litigating RICO claims for each class member against all non-issuing Defendants. Because each policyholder is entitled to recover in full from each Defendant found to have participated in the alleged conspiracy to overcharge, Defendants' arguments relating to arbitration agreements are not a barrier to certification.[36]

In addition to the foregoing, the Court believes class treatment is superior due to the existence of Wall Street's Trial Plan as described in Section II(B) *supra*. At this juncture, the Court declines to formally adopt Wall Street's Trial Plan. Nevertheless, the Court is influenced by the existence of such a thorough plan for trying this class action to the extent of deeming the class manageable.[37] Defendants urge that the proof required in this trial would focus on the knowledge of thousands of individuals who participated in the negotiation of insurance policies, and that individual issues concerning these transactions will make trial unmanageable. The Court believes that Wall

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[36] The Court may also divide the class into subclasses based on such arbitration agreements if the need arises. *See* FED. R. Civ. P. 23(c)(4).

[37] Furthermore, the Fifth Circuit has stated that "[a]nother consideration in favor of finding predominance is that if the defendants prevail on the liability issues, damages will be moot." *Bertulli*, 242 F.3d at 298 n. 37 (citing *Mullen*, 186 F.3d at 626). Here, as demonstrated in Wall Street's Trial Plan, if defendants prevail on liability, the damage calculation issue will be moot. Accordingly, this weighs in favor of finding the class manageable. *See id.*

Street has sufficiently addressed such concerns through the steps outlined in its Trial Plan.

In closing, the Court is of the opinion that a class action – rather than innumerable individual actions – is the better method of litigating this dispute. Keeping in mind the existence of Wall Street's Trial Plan to manage the case, the Court's ability to divide the class into subclasses at a later date if appropriate,[38] and the appointment of a special master if warranted,[39] the Court determines that the motion for certification should be granted. Given the foregoing, the Court hereby

ORDERS that Wall Street's motion for class certification of a class consisting of:

> All purchasers (excluding policyholders with a captive insurance company that ultimately reinsure their workers' compensation risk, the defendants and co-conspirators) of workers' compensation insurance policies, effective on or after January 1, 1987, endorsed with a Retrospective Premium Endorsement (NCCI form WC 00 05 series) and not closed by a final premium calculation on or before May 6, 1994, excluding purchasers of policies endorsed as a Large Risk Alternative Rating Option

is GRANTED.

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[38] *See* FED. R. Civ. P. 23(c)(4).

[39] *See* FED. R. Civ. P. 53(a), (b).

SIGNED at Houston, Texas, on this 8 day of August, 2001.

/s/ David Hittner
DAVID HITTNER
United States
District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Sandwich Chef of Texas, Inc. d/b/a Wall Street Deli, Individually and for Others Similarly Situated,	§	
Plaintiffs,	§	Civil Action No. H-98-1484
vs.	§	
Reliance National Indemnity Insurance Company f/k/a Planet Insurance Company, et al.,	§	
Defendants.	§	

ORDER

(Filed Aug. 8, 2001)

Pending before the Court is the Motion to Sever Reliance's Permissive Counterclaim filed by Plaintiff Sandwich Chef of Texas d/b/a Wall Street Deli (Document #417). Having considered the motion, submissions and applicable law, the Court determines that the motion should be granted.

Plaintiff Sandwich Chef of Texas d/b/a Wall Street Deli ("Wall Street") filed suit against Defendant Reliance National Indemnity Insurance Company ("Reliance") and other insurance companies, asserting that Defendants violated the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 ("RICO"). Wall Street seeks to recover RICO damages for itself and a proposed class of employers who purchased retrospectively rated workers' compensation insurance in one or more of forty-four states and the District of Columbia.

On December 14, 2000, Defendant Reliance filed a counterclaim for breach of contract against Wall Street, alleging that Wall Street failed to pay workers' compensation premiums as well as automobile and general liability insurance premiums. Wall Street subsequently filed a class action counterclaim to Reliance's counterclaim, asserting claims for breach of contract and fraud based upon Reliance's automobile and general liability insurance counterclaim.

Wall Street contemporaneously filed the instant motion to sever pursuant to Federal Rule of Civil Procedure 21. Wall Street asks the Court to sever Reliance's counterclaim (based on automobile and general liability insurance premiums) together with Wall Street's class action counterclaim, as demonstrated below:

PLEADING	CLAIM	BASED UPON
Wall Street's Original Class Action Claim	RICO	Workers' Compensation (scheme to defraud)
Reliance's Counterclaim	Breach of Contract	Workers' Compensation (premiums)
	*Breach of Contract	Automobile & General Liability Insurance (premiums)
Wall Street's Class Action Counterclaim	*Breach of Contract & Fraud	Automobile & General Liability Insurance (deductibles)

**Claims that Wall Street seeks to sever in the instant motion.*

The parties dispute whether Reliance's counterclaim concerning alleged nonpayment of automobile and general liability insurance premiums is a compulsory counterclaim.[1] Compulsory counterclaims are claims against an opposing party that arise out of the transaction or occurrence that is the subject matter of the opposing party's claim. FED. R. CIV. P. 13(a). In determining whether a claim is a compulsory counterclaim, courts should ask: (1) whether the issues of fact and law raised by the claim and counterclaim are largely the same, (2) whether res judicata would bar a subsequent suit on defendant's claim absent the compulsory counterclaim rule, (3) whether substantially the same evidence will support or refute plaintiff's claim as well as defendant's counterclaim, and (4) whether there is any logical relationship between the claim and the counterclaim. *E.g., Tank Insulation Int'l v. Insultherm, Inc.,* 104 F.3d 83, 85-86 (5th Cir. 1997). If any question is answered in the affirmative, the counterclaim is compulsory. *Id.* at 86. The Fifth Circuit follows the "logical relationship" inquiry, giving consideration to "whether the claim and counterclaim share an 'aggregate of operative facts.'" *E.g., New York Life Ins. Co. v. Deshotel,* 142 F.3d 873, 882 (5th Cir. 1998) (citing *McDaniel v. Anheuser-Busch, Inc.,* 987 F.2d 298, 304 (5th Cir. 1993)).

The Fifth Circuit employs a liberal test for determining whether counterclaims are compulsory, predicated on

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[1] Wall Street argues that the counterclaim relating to automobile and general liability insurance premiums is in fact a claim for alleged nonpayment of deductible automobile and general liability insurance premiums. The Court notes this disagreement but will refer to Reliance's claim as one for premiums (rather than deductibles) for the sake of consistency.

the policy that related disputes between parties should be settled in a single lawsuit. *E.g., Plant v. Blazer Fin. Servs., Inc. of Georgia,* 598 F.2d 1357, 1361 (5th Cir. 1979); *see also* 6 CHARLES ALAN WRIGHT, ARTHUR R. MILER [sic] AND MARY KAY KANE, FEDERAL PRACTICE & PROCEDURE § 1410, p. 50 (2d ed. 1990). However, "even the most liberal construction of the provision cannot operate to make a counterclaim that arises out of an entirely different or independent transaction or occurrence compulsory under Rule 13(a)." WRIGHT ET AL. at § 1410, p. 51-52.

Wall Street argues in its motion to sever that "[a]lthough Reliance's counterclaim concerning Wall Street's alleged non-payment of deductible automobile and general liability insurance premiums relates to insurance, it goes far beyond the narrow issue of fraudulent workers' compensation billings alleged in Wall Street's complaint. Simply put, the claims are not offshoots of the same controversy." In response, Reliance contends that the pricing for Wall Street's automobile, workers' compensation, and general liability insurance was negotiated and sold in one transaction; thus, its counterclaim based on this single transaction constitutes a compulsory counterclaim.

In this case, the transaction that is the subject matter of Wall Street's RICO claim is different from the transaction relating to Reliance's counterclaim for automobile and general liability insurance premiums. The transaction that forms the basis of Wall Street's original claim is an alleged scheme by Defendants to defraud workers' compensation policyholders. In contrast, Reliance's counterclaim is based upon a transaction between Wall Street and Reliance involving the negotiation and pricing of Wall Street's insurance policies. Although the Supreme Court has stated

that the term "transaction" is a word of flexible meaning, *e.g., Moore v. New York Cotton Exchange,* 270 U.S. 593 (1926), in this case the transaction at the core of Wall Street's RICO claim is unrelated to the transaction concerning Reliance's breach of contract counterclaim.[2]

The Court also notes that Wall Street's original claim and Reliance's counterclaim do not arise from the same aggregate of operative facts. First, there are significant factual distinctions between the workers' compensation policies, which form the basis of Wall Street's RICO claim, and the automobile and general liability insurance policies, which form the basis of Reliance's counterclaim.[3] Second, Wall Street's original claim is based on an entirely different legal theory than Reliance's counterclaim – i.e., RICO versus breach of contract. Third, the negotiation of insurance premiums is not at issue in Wall Street's RICO claim. Wall Street's original claim is based upon the Defendants' alleged inflation of residual market subsidies that were fixed by filed rates, not upon Defendants' negotiation of the insurance policies and resulting premium payments.

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[2] The Court finds the reasoning in *United States v. Mueller,* 184 F.R.D. 686 (M.D. Fla. 1999), to be persuasive. In *Mueller,* the court determined that a counterclaim was not compulsory when the original complaint was based on fraudulent statements to Medicaid and the counterclaim was based on failure to pay for prescriptions *Id.* at 687.

[3] For example: (1) each insurance policy is a separate contract with distinct policy numbers, coverage conditions, terms and exclusions; and (2) the deductible insurance for the automobile and general liability policy is different and unrelated to the workers' compensation retrospectively-rated insurance (which has no deductibles).

Moreover, the situation here is distinguishable from Fifth Circuit cases finding that the logical relationship test is met when a transaction gives rise to both plaintiff's and defendant's claims. *See, e.g., Deshotel,* 142 F.3d at 882 (claim and counterclaim arose from the purchase of life insurance and subsequent beneficiary designation; further, plaintiff did not argue that the claims were not logically and factually related); *McDaniel,* 987 F.2d at 304 (claims and counterclaims all arose from single accident at railyard); *Plant,* 598 F.2d at 1361 (single loan transaction gave rise to truth-in-lending action and debt counterclaim). Here, as discussed *supra,* the transaction that is the focus of Wall Street's original claim is unrelated to the transaction at issue in the counterclaim. Accordingly, the above cases do not lead to a conclusion that Reliance's counterclaim is a compulsory counterclaim.

Given the foregoing, the Court determines that Reliance's counterclaim is not a compulsory counterclaim under Rule 13(a), but rather, is a permissive counterclaim under Rule 13(b). Pursuant to Rule 21, the Court determines that Reliance's counterclaim, together with Wall Street's class action counterclaim, should be severed from the instant action. *See* FED. R. CIV. P. 21 ("Any claim against a party may be severed and proceeded with separately.").

Finally, the Court declines Reliance's request to require Wall Street to replead its class action counterclaim for breach of contract and fraud in an amended complaint. To do so at this time would be unfairly prejudicial to Wall Street's motion for class certification. Accordingly, Reliance's request is denied. Given the foregoing, the Court hereby

ORDERS that the Motion to Sever Reliance's Permissive Counterclaim filed by Plaintiff Sandwich Chef of Texas d/b/a Wall Street Deli (Document #417) is GRANTED. Defendant Reliance National Indemnity Insurance Company's permissive counterclaim (asserting a claim for breach of contract based upon automobile and general liability insurance premiums) and Plaintiff Sandwich Chef of Texas, Inc. d/b/a Wall Street Deli's class action counterclaim (asserting claims for breach of contract and fraud based upon automobile and general liability insurance deductibles) are hereby SEVERED from the instant action pursuant to Federal Rule of Civil Procedure 21. The Court further

ORDERS that these severed claims be given a new file number, H-98-1484(A), so that independent judgment may be rendered by this Court. The Court further

ORDERS that the parties refile, under file number H-98-1484(A), the severed claims as a complaint and counterclaim within ten days of entry of this order.

SIGNED at Houston, Texas, on this 8 day of August, 2001.

/s/ David Hittner
DAVID HITTNER
United States
District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SANDWICH CHEF OF TEXAS, INC. D/B/A WALL STREET DELI, FOR THEMSELVES AND FOR OTHERS	§	
Plaintiffs,	§	
v.	§	CIVIL ACTION NO. H-98-1484
RELIANCE NATIONAL INDEMNITY INSURANCE COMPANY F/K/A PLANET INSURANCE COMPANY RELIANCE LLOYDS, RELIANCE NATIONAL INSURANCE COMPANY AND UNITED PACIFIC INSURANCE COMPANY, ET AL.,	§	
Defendants.	§	

ORDER

(Filed Aug. 28, 2000)

Pending before the Court is the Supplemental Motion for Summary Judgment (Document #282) filed by Defendants. Having considered the motion, submissions, and application of law, together with the arguments of counsel at a hearing conducted by the Court on August 15, 2000, the Court determines that the motion for summary judgment should be denied.

Plaintiff Sandwich Chef of Texas, Inc. d/b/a Wall Street Deli ("Wall Street") filed a class action complaint against numerous defendants. Plaintiff alleges it and the

proposed class have been defrauded by the concerted acts of the defendants and have been required to pay excessive workers' compensation premiums during the last decade. Wall Street and members of the putative class are employers that purchased retrospectively rated workers' compensation insurance. Retrospectively rated workers' compensation insurance combines expense factors and loss experience together in varied ways, such that the amount of the premium at the end of the policy period is affected by the amount of the insured's covered losses. When the loss experience is less than anticipated, refunds or credits are issued; when the loss experience is greater than anticipated, additional premiums are required.

Most employers purchase workers' compensation coverage in the voluntary market. Employers that are unable to secure coverage in the voluntary market may obtain it through legislatively established involuntary markets, which are sometimes called "residual markets," "assigned risk markets," or "assigned risk pools." In order to obtain authorization to write worker's compensation insurance in some states, insurers must agree to reinsure the "residual markets" of those states. As reinsurers of residual markets in some jurisdictions, insurance companies are often required to pay assessments necessary to fund deficits that result when workers' compensation losses incurred by employers insured through such residual markets exceed premiums paid by those employers.

Beginning in the late 1980s, residual-market assessments began to increase dramatically. Insurance companies responded to the increases in residual market assessments by factoring the expenses associated with paying these assessments in the pricing of voluntary-market insurance programs. Insurance program documents disclosed the

factoring of these expenses in pricing by explicitly identifying these "residual market charges" (also known as "residual market loads" or "RMLs").

Wall Street alleges that from May 5, 1988 through January 4, 1990, approximately 150 insurance carriers charged excessive premiums for workers' compensation insurance sold to a putative class consisting of thousands of employers in 44 states and in the District of Columbia. Wall Street contends that the defendant insurers employed the National Council on Compensation Insurance, Inc. ("NCCI"), an insurance trade organization, which includes as members persons employed by the defendant insurers, as a racketeering enterprise to defraud a putative class of insureds through a common scheme of mail and wire fraud, in violation of 18 U.S.C. §§ 1962(c)-(d).

Defendants have filed a motion for summary judgment on several grounds. First, defendants argue that Wall Street's "invoice theory" fails to allege indictable acts of racketeering. According to defendants, to establish mail or wire fraud after Neder v. United States, 527 U.S. 1 (1999), Wall Street must prove a material misrepresentation that would support a claim for common-law fraud. At most, the defendants contend, Wall Street's "invoice theory" alleges that one defendant insurer, Reliance, sent invoices to Wall Street that constitute misrepresentations of law in the performance of contractual duties, which are not actionable in fraud.

Second, defendants argue that summary judgment is proper because Wall Street fails to allege a viable basis for finding that it suffered its alleged injuries "by reason of" the alleged misrepresentations in Reliance's invoices. To prove an injury "by reason of" mail and wire fraud within

the meaning of 18 U.S.C. § 1964(c), a RICO plaintiff must plead and prove that it relied on the misrepresentations constituting the predicate acts of mail and wire fraud. According to the defendants, state and federal law conclusively presumes that policy holders know the contents and effects of applicable filed rates, and this "presumption of knowledge" precludes a finding that Wall Street relied on Reliance's alleged misrepresentations concerning the conformity of Wall Street's negotiated rates with allegedly applicable filed rates.

Third, according to the defendants, the summary judgment evidence establishes that Reliance never lied to Wall Street about the legality of Wall Street's premiums or the conformity of those premiums to state filed rates. Rather, contend the defendants, Wall Street always knew that Reliance would adjust (and did adjust) Wall Street's premiums using the unfiled and unapproved "tax multipliers" and "residual market loads" that Wall Street is challenging.

Fourth, according to the defendants, Wall Street cannot prove that Reliance or any other entity made any misrepresentations to any state regulators regarding any of the insurance programs upon which Wall Street is basing this case. Also, defendants argue that Wall Street cannot prove that it relied upon any misrepresentation made to any regulator regarding any policies issued to policy holders.

Fifth, the defendants assert that the McCarran-Ferguson Act entitles them to summary judgment on Wall Street's claims. Specifically, the defendants argue that awarding Wall Street treble damages under the RICO statute for allegedly fraudulent departures from the filed rates would frustrate non-discrimination policies declared

in state insurance laws requiring insurers to collect the full amount of any applicable filed rate and preclude any remedy that would effectively grant any policy holder a refund of any portion of a filed rate.

Sixth, the defendants argue that they are entitled to summary judgment on Wall Street's conspiracy claim under section 1962(d). A claim under section 1962(d) based on an alleged conspiracy to violate section 1962(c) through a pattern of racketeering necessarily fails as a matter of law where the plaintiff cannot prove that the defendants committed predicate acts of racketeering or that the plaintiff suffered an injury to its business or property "by reason of" those acts.

Summary judgment is mandated "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). Initially, the movant bears the burden of demonstrating to the Court that there is an absence of a genuine issue of any material fact. Id. at 323. The burden then shifts to the party who bears the burden of proof on the claims on which summary judgment is sought to present evidence beyond the pleadings to show there is a genuine issue for trial. Id. A genuine issue for trial exists when "there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party. If the evidence is merely colorable, or is not significantly probative, summary judgment may be granted." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249-50 (1986) (citations omitted).

To recover under 18 U.S.C. § 1964(c) for injuries suffered by reason of a violation of § 1964(c) through a

pattern of racketeering, a plaintiff must plead and prove, in part, that: (1) the defendant committed two or more predicate acts of racketeering, and (2) the plaintiff suffered an injury to its business or property "by reason of" those predicate acts.

The defendants argue that Wall Street cannot prove that the defendants violated the mail and wire fraud statute. The defendants cite the Supreme Court opinion in Neder v. United States, 527 U.S. 1 (1999) for the proposition that Congress intended to incorporate the requirements of common law fraud into the federal mail and wire fraud statutes. Thus, the defendants argue that proving mail fraud requires proof of a material misrepresentation that would support a claim for common-law fraud.

The defendants first argue that misrepresentations made in invoices, like other misrepresentations made in the performance of a contract, are not actionable in fraud. See Perlman v. Zell, 185 F.3d 850 (7th Cir. 1999). In response, Wall Street cites to numerous cases for the proposition "that to knowingly distribute inflated billings is common law fraud." See Wall Street's Response to Defendants' Supplemental Motion for Summary Judgment at 43.

The Court determines that overbilling during the performance of a contract may be the basis for a civil RICO mail fraud case. In Neder, a case cited by the defendants, Neder was prosecuted under the criminal RICO statute for mail fraud within loan and construction contracts. Further, while the defendants are correct that Perlman stated, "[it is] difficult to recast a dispute about broken promises into a claim of racketeering under RICO," the Perlman court also noted that "[d]ifficult is not impossible.

Sometimes the evidence shows outright lies and a plan not to keep one's promises." Perlman, 185 F.3d at 853. Accordingly, the facts as alleged by Wall Street – that Reliance engaged in a scheme to intentionally overbill its insured for workers' compensation insurance – may support a claim under RICO.

The defendants further argue that misrepresentations of law are not actionable in fraud. Specifically, defendants contend that the misrepresentations made in the Reliance invoices – that the amounts they demanded did not exceed applicable filed rates – would not be actionable in fraud because the invoices would be falsely representing that the amounts demanded were lawful. Thus, any misrepresentation by Reliance that an amount charged was lawful was, at most, a misstatement of law regarding the legal consequence of the relevant regulations and filings that is not cognizable as a fraud.

The Court disagrees with this argument. Wall Street has provided summary judgment evidence that establishes that Reliance knew that the invoices included overcharges that exceeded the filed rate. These alleged misrepresentations are construed by this Court as alleged misstatements of fact, which are actionable in fraud.

Reliance next argues that Wall Street cannot establish that it suffered an injury "by reason of" the alleged misrepresentations in Reliance's invoices. In the supplemental motion for summary judgment, defendants extensively discuss the issue of whether Wall Street reasonably could have relied upon any alleged misrepresentations in the invoices. Pursuant to RICO, a plaintiff must establish that it suffered an injury "by reason of" the predicate acts of mail or wire fraud.

Defendants first argue that Wall Street must plead and prove that it reasonably or justifiably relied upon any alleged misrepresentation in the invoices. According to the defendants, any reliance by Wall Street that the invoices were consistent with the filed rates would not be reasonable because consumers are "conclusively presumed" to know the content and effects of applicable filed rates. See, e.g., Marcus v. AT&T Corp., 138 F.3d 46, 63 (2d Cir. 1998) ("As a matter of law, it would not be reasonable for a consumer to harbor a belief about AT&T's billing practices that is inconsistent with the tariff AT&T has filed with the FCC.") Moreover, the defendants argue that Wall Street agreed, by contract, to pay a rate higher than the filed rate.

The filed rate doctrine is based on the principle that a regulated entity may not engage in pricing discrimination between ratepayers, i.e., all rate payers must be charged the same rate for services (non-discrimination strand). Furthermore, the state regulatory agency shall be the exclusive source of establishing rates for a particular entity (nonjusticiability strand). Marcus, 138 F.3d at 489. Thus, argues Wall Street, a purchaser of a commodity regulated by a filed rate cannot be forced to pay a rate higher than the filed rate, even if it agreed to do so by contract. See Arkansas Louisiana Gas Co., 453 U.S. 571, 582 (1981); Stein v. Sprint Corp., 22 F. Supp.2d 1210, 1212 (D. Kan. 1998) ("Regardless of the carrier's motive – whether it seeks to benefit or harm a particular customer – the policy of nondiscriminatory rates is violated when similarly situated customers pay different rates for the same services.") Wall Street contends that if it were forced to pay an amount more than the filed rate, it would be

subject to the discriminatory pricing practices that the filed rate doctrine is intended to preclude.

All of the cases the defendants have cited to support their contention that Wall Street is barred from proving that it reasonably relied upon any misrepresentations made by an invoice, that purportedly represented that the amount it charged did not exceed an applicable filed rate, are cases in which the consumers were attempting to obtain an assessment lower than the applicable filed rate. The principle espoused in these cases is different from the instant case where Wall Street is attempting to *enforce* the filed rate.

Despite the defendants' analysis to the contrary, this Court finds persuasive the courts' reasoning in Drew v. MCI Worldcom Management Co., Inc., 1999 WL 1087470 (N.D. Tex. December 1, 1999) and Black Radio Network, Inc. v. NYNEX Corp., 44 F. Supp.2d 565, 574 (S.D.N.Y. 1999). In Drew, the claimant filed a class action complaint pursuant to RICO to recover damages from MCI for charging long distance customers a fee that exceeded the approved amount in the tariff. MCI moved to dismiss the plaintiff's claim under the filed rate doctrine. The court denied MCI's motion stating that "the purposes of the filed tariff doctrine have no apparent relevance to Drew's claims to enforce the part of the MCI tariff that pertains to the FUSF."

In reaching this conclusion, the Drew court relied upon the reasoning in Black Radio, where the court found that the filed rate doctrine had no application to a defense to RICO claims where the plaintiffs sought to enforce the filed rates.

> The filed rate doctrine is inapplicable because plaintiffs do not challenge, either directly or indirectly, the reasonableness of the rate contained in any filed tariff. Nor do plaintiffs seek to benefit from a rate different from that provided by the tariff. Rather, plaintiffs contend that defendants failed to comply with the terms of the tariff and they seek, in essence, to enforce the filed tariff. Hence, plaintiffs' claims do not implicate either the nondiscrimination or nonjusticiability strands of the filed rate doctrine. . . . Nor will plaintiffs' claims undermine the PSC's regulatory authority.

Black Radio, 44 F. Supp.2d at 574 (citations omitted). Thus, as clearly stated in Black Radio, "presumed knowledge" of filed rates, that defendants have argued precludes Wall Streets' [sic] ability to establish "reliance" on any misrepresentations in the invoices, is inapplicable in this case.

The defendants next argue that even assuming the invoices constitute indictable acts of mail or wire fraud and even assuming that the presumption of knowledge did not preclude a finding that Wall Street's payment of those invoices constitutes an injury "by reason of" such acts, the facts nevertheless would preclude recovery under section 1964(c) based on Wall Street's invoice-payment theory. Specifically, defendants argue that the summary judgment evidence establishes: (a) Reliance's invoices to Wall Street made no representations concerning the legality or illegality of the amounts they demanded, and (b) Wall Street knowingly agreed to have its insurance premiums calculated using the unfiled tax multipliers it challenges through this action.

The Court disagrees with the assumption asserted by the defendants: that the invoices would have to have

stated that they included only legal charges in order for the invoices to constitute a misrepresentation. Any statement short of such an assertion, contend the defendants, bars Wall Street's RICO claim. The summary judgment evidence presented sufficiently creates a fact issue with respect to whether the invoices by themselves constitute "misrepresentations."

Similarly, the summary judgment evidence presented creates a genuine issue of material fact concerning whether Wall Street relied on the invoices to its detriment. The defendants' position is that Wall Street agreed from the beginning of its relationship with Reliance that Reliance would include unfiled and unapproved residual market loads in the unfiled and unapproved tax multipliers that Reliance would use to calculate the retrospective adjustments of the premiums for Wall Street's insurance programs and that, as a result, the invoices Wall Street would receive from Reliance would include unapproved and unfiled charges for residual market loads. However, the summary judgment evidence indicates that Wall Street assumed that the charges it had agreed to were legal and consistent with the filed rate. The Court is unwilling to find at this time that Wall Street's assumption – that what it was agreeing to be charged was a legal rate, consistent with the filed rate – is an unreasonable assumption. The Court is further unwilling to find at this time, as the defendants suggest, that Wall Street's assumption that it was being charged a legal rate cannot be the basis of a misrepresentation. Likewise, the Court finds the defendants' argument that Wall Street was on notice that it was subject to illegal or unlawful charges after it participated in the Weatherford action to be unconvincing. Again, it would not be unreasonable for Wall Street to

assume that Reliance's invoices contained only legal RMLs after the filing of both the Weatherford action and this action. Thus, there is sufficient summary judgment evidence to create a fact question regarding the reliance issue.

Defendants argue that Wall Street's "fraud-on-the-regulator" theory is barred pursuant to the Fifth Circuit's recent opinion in Summit Properties, Inc. v. Hoechst Celanese Corp., 214 F.3d 556 (5th Cir. 2000). In Summit, the Fifth Circuit analyzed whether plaintiffs, a class of property owners whose homes were built with polybutylene ("PB") plumbing systems, could assert a RICO claim against the manufacturers of the PB. The Fifth Circuit found that the plaintiffs could not seek RICO damages against the PB manufacturers because any fraud during the sale of the PB products "proximately injured only those purchasers who relied on the alleged misrepresentations, since the fraud facilitated a sale that might not otherwise have been made." Summit, 214 F.3d at 560. Because the plaintiffs in Summit came into possession of the PB products without relying on the alleged fraud, any past fraud was not a proximate cause of the plaintiffs' resulting injuries. Id.

The defendants argue that Wall Street's claim, that it relied to its detriment on misrepresentations sent to state regulators, cannot survive after Summit. Wall Street responds that Summit does not foreclose their fraud-on-the-regulator claim. The Summit court noted that fraud addresses "liability between persons with direct relationships – assured by the requirement that the plaintiff has either been the target of a fraud or has relied upon the fraudulent conduct of the defendants." Id. at 561.

The Fifth Circuit however, did reference the concept of the "target wing" in applying RICO in certain cases in which direct reliance may not exist. Id. at 561 (citing Mid Atlantic Telecom. Inc. v. Long Distance Servs., Inc., 18 F.3d 260, 263-64 (4th Cir. 1994)). Mid Atlantic discusses the "by reason of" language of RICO, without ultimately reaching the issue of "reliance." In Mid Atlantic, the plaintiffs filed a RICO complaint based on the fact that the defendant had allegedly engaged in a fraudulent scheme to lure the plaintiffs' customers away. The defendants had argued that because the plaintiffs were not the direct targets of the alleged fraud they could not establish that they were injured "by reason of" the defendants' actions.

In rejecting this argument, the court found that "Mid Atlantic's injuries, as alleged, are not derivative of any losses suffered by its former customers. Rather, it claims distinct and independent injuries; lost customers and lost revenues due to the necessity of offering lower rates to match LDS's fraudulent ones." Id. at 264.

Likewise, Wall Street's fraud-on-the-regulator is cognizable as a RICO claim after Summit because Wall Street has established through the summary judgment evidence that the defendants engaged in a scheme to collect phantom premiums through misrepresentations made to insurance regulators. The summary judgment evidence establishes direct injury to Wall Street from the defendants' alleged misrepresentations made to it and to state regulators. These allegations are sufficient to establish predicate racketeering acts of mail and wire fraud when the defendants, or the NCCI, at their direction, submitted false rates filings and applications. The allegations of fraud, through the scheme to collect excessive workers' compensation premiums, is sufficient to satisfy

RICO after Summit. See Summit, 214 F.3d at 561 ("Accepting as claimed that the defendants' strategy may have been to gain market share by fraud in the initial sale of PB components, it is not contended that these particular plaintiffs were the targets of *scheme to defraud accomplished by defrauding others.*") (emphasis added).

Defendants' final argument is that awarding Wall Street treble damages under RICO would violate the McCarran-Ferguson Act by frustrating non-discrimination policies declared in state insurance statutes requiring insurers to collect the full amount of any applicable filed rate and precluding any remedy that would effectively grant any policyholder a refund of any portion of the applicable filed rate. The McCarran-Ferguson Act precludes application of a federal statute in face of state law "enacted . . . for the purpose of regulating the business of insurance." 15 U.S.C. § 1011-1012 (1997).

Wall Street argues that the recent Supreme Court opinion in Humana v. Forsyth, 525 U.S. 299 (1999), clearly contradicts the defendants' argument that the McCarran-Ferguson Act precludes application of RICO in this case. The plaintiffs in Humana were beneficiaries of group health insurance policies issued by Humana Insurance. Between 1985 and 1988, plaintiffs received medical care from a certain hospital. Humana agreed to pay 80% of the policy beneficiaries' hospital charges over a designated deductible. The beneficiaries paid the remaining 20% of the charges. However, pursuant to a concealed agreement, the hospital gave Humana large discounts on its portion of the hospital charges for care provided to the policy beneficiaries. As a result, Humana paid significantly less than the 80% of the hospital's actual charges for the care that

the policy beneficiaries received and the beneficiaries paid significantly more than 20% of those charges.

Plaintiffs sued under RICO. Humana moved for summary judgment citing section 2(b) of the McCarran-Ferguson Act which provides, "no Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." 15 U.S.C. § 1012(b) (1997).

The district court granted the motion for summary judgment finding that RICO's treble damage provision exceed [sic] the state's permissible penalties for insurance fraud such that applying RICO would be "tantamount to allowing Congress to intercede in an area expressly left to the states under the McCarran-Ferguson Act." Humana, 525 U.S. at 304-05 (citing Forsyth v. Humana, 827 F. Supp. 1498, 1521-1522 (D. Nev. 1993)). The Ninth Circuit reversed in part, determining that the McCarran-Ferguson Act does not preclude "application of a federal statute prohibiting acts which are also prohibited under a state's insurance laws." Humana, 114 F.3d 1467, 1482 (9th Cir. 1997).

The Supreme Court granted certiorari on the following question: "Does a federal law, which proscribes the same conduct as state law, but provides materially different remedies, "impair" state law under the McCarran-Ferguson Act?" Humana, 525 U.S. at 305. In answering this question in the negative, the Supreme Court held, "when federal law does not directly conflict with the state regulation, and when application of the federal law would not frustrate any declared state policy or interfere with a

State's administrative regime, the McCarran-Ferguson Act does not preclude its application." Id. at 309.

Defendants argue that Humana is distinguishable on its facts from the instant case. According to defendants, Humana is not controlling because it was not a filed rate case. In this case, if the RICO claims were to proceed, Wall Street could recoup damages, which would in effect interfere with the states' filed rate for workers' compensation premiums. Thus, the defendants state that Humana establishes that McCarran-Ferguson precludes RICO's application not only when applying RICO would "directly conflict with state regulation" of insurance but also when applying RICO would "frustrate [a] declared state policy or interfere with a State's administrative regime." Id.

The Court disagrees. While Humana is not a filed rate case, the fundamental principle in the case governs the issues before this Court. Application of RICO in this case does not directly conflict with any state regulation, but rather, complements the states' regulations by enforcement. Id. at 308. Accordingly, allowing Wall Street to proceed with its RICO claims does not implicate the McCarran-Ferguson Act.

The defendants' final argument is that summary judgment should be granted on Wall Street's conspiracy claim under section 1962(d). The defendants argue that "[a]ny claim under section 1962(d) based on a conspiracy to violate the other subsections of section 1962 necessarily must fail if the substantive claims are themselves deficient." See Defendants' Supplemental Motion for Summary Judgment at 47 (citing Lightning Lube, Inc. v. Witco Corp., 4 F.3d 1153, 1191 (3d Cir. 1993)). However, as discussed supra, the Court determines that Wall Street's section

1962(c) claims survive summary judgment. As such, Wall Street's section 1962(d) claims survive as well.

Based on the foregoing, the Court hereby

ORDERS that the Supplemental Motion for Summary Judgment (Document #282) is DENIED.

SIGNED at Houston, Texas, on this 28 day of August, 2000

/s/ David Hittner
DAVID HITTNER
United States District Judge

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 01-20924

SANDWICH CHEF OF TEXAS, INC,
doing business as Wall Street Deli,
Individually and for others similarly situated

Plaintiff-Appellee

v.

RELIANCE NATIONAL INDEMNITY INSURANCE CO, formerly known as Planet Insurance Company; RELIANCE INSURANCE COMPANY; RELIANCE LLOYDS; RELIANCE NATIONAL INSURANCE CO; UNITED PACIFIC INSURANCE CO; HOME INSURANCE COMPANY, formerly known as City Insurance Co, formerly known as Home Indemnity Company, formerly known as Home Insurance Company, formerly known as Home Insurance Company of Indiana; LIBERTY MUTUAL INSURANCE COMPANY; LIBERTY MUTUAL FIRE INSURANCE COMPANY; LIBERTY INSURANCE CORPORATION; AMERICAN & FOREIGN INSURANCE COMPANY; GLOBE INDEMNITY CO; ROYAL INDEMNITY CO; ROYAL INSURANCE COMPANY OF AMERICA; SAFEGUARD INSURANCE CO; BITUMINOUS CASUALTY CORPORATION; BITUMINOUS FIRE AND MARINE INSURANCE CO; GREAT WEST CASUALTY INSURANCE CO; INTERNATIONAL BUSINESS & MERCANTILE REASSURANCE CO; OLD REPUBLIC INSURANCE COMPANY; NORTH RIVER INSURANCE CO; INTERNATIONAL INSURANCE COMPANY; WESTCHESTER FIRE INSURANCE COMPANY; UNITED STATES FIRE INSURANCE COMPANY;

UNITED STATES FIDELITY AND GUARANTY COMPANY; FIDELITY & GUARANTY INSURANCE UNDERWRITERS INC; INDUSTRIAL INDEMNITY; CHUBB INDEMNITY INSURANCE CO; CHUBB LLOYDS INSURANCE CO OF TEXAS; FEDERAL INSURANCE COMPANY; GREAT NORTHERN INSURANCE CO; NORTHWESTERN PACIFIC INDEMNITY CO; PACIFIC INDEMNITY COMPANY; SUN INSURANCE OFFICE OF AMERICA INC; TEXAS PACIFIC INDEMNITY CO; VIGILANT INSURANCE CO; HIGHLANDS INSURANCE COMPANY; HIGHLANDS UNDERWRITERS INSURANCE CO; HIGHLANDS CASUALTY CO; ABERDEEN INSURANCE CO; BANKERS STANDARD INSURANCE CO; CENTURY INDEMNITY CO; INDEMNITY INSURANCE COMPANY OF NORTH AMERICA; INSURANCE COMPANY OF NORTH AMERICA; PACIFIC EMPLOYERS INSURANCE COMPANY; ATLANTIC INSURANCE CO; AUTOMOBILE INSURANCE COMPANY OF HARTFORD CONNECTICUT; CHARTER OAK FIRE INSURANCE COMPANY; FARMINGTON CASUALTY CO; GULF GROUP LLOYDS; GULF INSURANCE CO; NIPPON FIRE/MARINE INSURANCE CO LTD, U S Branch; PHOENIX INSURANCE COMPANY; SELECT INSURANCE CO; STANDARD FIRE INSURANCE CO; TRAVELERS CASUALTY & SURETY CO, formerly known as Aetna Casualty & Surety Co; TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA, formerly known as Aetna Casualty and Surety Company of America; TRAVELERS CASUALTY & SURETY COMPANY OF ILLINOIS, formerly known as Aetna Casualty & Surety Company of Illinois; TRAVELERS INDEMNITY COMPANY; TRAVELERS INDEMNITY COMPANY OF AMERICA; TRAVELERS INDEMNITY COMPANY OF CONNECTICUT, THE, formerly known as Travelers Indemnity Company of Rhode Island; TRAVELERS INDEMNITY CO OF ILLINOIS; TRAVELERS INSURANCE COMPANY; ARGONAUT

INSURANCE COMPANY; ARGONAUT MIDWEST INSURANCE COMPANY; ARGONAUT SOUTHWEST INSURANCE COMPANY; AMERICAN HOME ASSURANCE COMPANY; BIRMINGHAM FIRE INSURANCE COMPANY OF PENNSYLVANIA; COMMERCE AND INDUSTRY INSURANCE CO; GRANITE STATE INSURANCE COMPANY; ILLINOIS NATIONAL INSURANCE COMPANY; THE INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA; NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA; NEW HAMPSHIRE INSURANCE COMPANY; AMERICAN MANUFACTURING MUTUAL INSURANCE CO.; AMERICAN MOTORISTS INSURANCE COMPANY; AMERICAN PROTECTION INSURANCE CO; LUMBERMENS MUTUAL CASUALTY COMPANY; EMCASCO INSURANCE CO; EMPLOYERS MUTUAL CASUALTY COMPANY; FARMLAND MUTUAL INSURANCE CO; NATIONWIDE AGRIBUSINESS INSURANCE CO; NATIONWIDE INDEMNITY INSURANCE CO; NATIONWIDE MUTUAL FIRE INSURANCE CO; NATIONWIDE MUTUAL INSURANCE COMPANY; NATIONWIDE PROPERTY AND CASUALTY INSURANCE CO; SCOTTSDALE INDEMNITY CO; MIDDLESEX INSURANCE CO; SENTRY INSURANCE, A Mutual Company; EMPLOYERS INSURANCE OF WAUSAU, A Mutual Company; WAUSAU BUSINESS INSURANCE CO; WAUSAU UNDERWRITERS INSURANCE COMPANY; AGRICULTURAL INSURANCE CO; AMERICAN ALLIANCE INSURANCE COMPANY; AMERICAN NATIONAL FIRE INSURANCE COMPANY; GREAT AMERICAN INSURANCE CO; MID-CONTINENT CASUALTY COMPANY; AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA; CONTINENTAL CASUALTY COMPANY; NATIONAL FIRE INSURANCE COMPANY OF HARTFORD; TRANSCONTINENTAL INSURANCE COMPANY; TRANSPORTATION INSURANCE COMPANY; VALLEY

FORGE INSURANCE COMPANY; BOSTON OLD COLONY INSURANCE COMPANY; CASUALTY INSURANCE COMPANY OF TEXAS; COMMERCIAL INSURANCE COMPANY OF NEWARK, NEW JERSEY; THE CONTINENTAL INSURANCE COMPANY; THE FIDELITY AND CASUALTY INSURANCE COMPANY NEW YORK; FIREMEN'S INSURANCE COMPANY OF NEWARK, NEW JERSEY; GLENS FALLS INSURANCE COMPANY; KANSAS CITY FIRE & MARINE INSURANCE CO; NIAGARA FIRE INSURANCE CO; AMERICAN GUARANTEE AND LIABILITY INSURANCE COMPANY; ZURICH INSURANCE COMPANY; REPUBLIC-FRANKLIN INSURANCE CO; UTICA MUTUAL INSURANCE CO; UTICA NATIONAL INSURANCE COMPANY OF TEXAS; FAIRMONT INSURANCE CO; TIG INSURANCE COMPANY OF TEXAS, formerly known as Transamerican Insurance Company of Texas; TIG PREMIER INSURANCE CO, formerly known as Transamerica Premier Insurance Company; ASSURANCE COMPANY OF AMERICA; MARYLAND CASUALTY CO; MARYLAND INSURANCE CO, formerly known as American General Fire and Casualty Company; NORTHERN INSURANCE COMPANY OF NEW YORK; VALIANT INSURANCE CO; AMERICAN AUTOMOBILE INSURANCE CO; AMERICAN INS. CO; ASSOCIATED INDEMNITY CORP; FIREMAN'S FUND INSURANCE COMPANY; FIREMAN'S FUND INSURANCE COMPANY OF TEXAS; FIREMAN'S FUND INSURANCE COMPANY OF WISCONSIN; NATIONAL SURETY CORP; THE CONNECTICUT INDEMNITY COMPANY; FIRE & CASUALTY INSURANCE COMPANY OF CONNECTICUT; SECURITY INSURANCE COMPANY OF HARTFORD; ACE FIRE UNDERWRITERS INSURANCE COMPANY, formerly known as Cigna Fire Underwriters Insurance Company; ACE AMERICAN INSURANCE COMPANY, formerly known as CIGNA Insurance Company; ACE PROPERTY AND CASUALTY

INSURANCE COMPANY, formerly known as CIGNA Property & Casualty Insurance Co; TIG AMERICAN SPECIALTY INSURANCE CO, formerly known as Chilton Insurance Co; TIG INSURANCE CO, formerly known as Transamerica Insurance Company; ACE INSURANCE COMPANY OF TEXAS, formerly known as Cigna Insurance Company of Texas; AMERICAN ZURICH INSURANCE COMPANY

Defendants-Appellants

Appeal from the United States District Court
for the Southern District of Texas, Houston

ON PETITION FOR REHEARING EN BANC

(Opinion 1/21/03, 5 Cir., ___, ___ F.3d ___)

(Filed Feb. 27, 2003)

Before SMITH and BENAVIDES, Circuit Judges, and FITZWATER, District Judge.*

PER CURIAM:

(X) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. No member of the panel nor judge in regular active service of the court having requested that the court be polled on Rehearing En Banc (FED. R. APP. P.

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* District Judge of the Northern District of Texas, sitting by designation.

* Judges King and Emilio M. Garza did not participate in the consideration of the rehearing en banc.

and 5TH CIR. R. 35), the Petition for Rehearing En Banc is DENIED.

( ) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. The court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service not having voted in favor (FED. R. APP. P. and 5TH CIR. R. 35), the Petition for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ JERRY E. SMITH
United States Circuit Judge

AMENDMENT V – GRAND JURY INDICTMENT FOR CAPITAL CRIMES; DOUBLE JEOPARDY; SELF-INCRIMINATION; DUE PROCESS OF LAW; JUST COMPENSATION FOR PROPERTY

No person shall be

* * *

deprived of life, liberty, or property, without due process of law;

* * *

RULES OF CIVIL PROCEDURE

Rule 52. Findings by the Court; Judgment on Partial Findings

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58;

* * *

Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.

* * *

RULES OF EVIDENCE

Rule 101. Scope

These rules govern proceedings in the courts of the United States and before the United States bankruptcy judges and United States magistrate judges, to the extent and with the exceptions stated in rule 1101.

Rule 1101. Applicability of Rules

(a) Courts and judges. These rules apply to the United States district courts, the District Court of Guam, the District Court of the Virgin Islands, the District Court for the Northern Mariana Islands, the United States court of appeals, the United States Claims Court, and to United States bankruptcy judges and United States magistrate judges, in the actions, cases, and proceedings and to the extent hereinafter set forth. The terms "judge" and "court" in these rules include United States bankruptcy judges and Untied States magistrate judges.

(b) Proceedings generally. These rules apply generally to civil actions and proceedings, including admiralty and maritime cases, to criminal cases and proceedings, to contempt proceedings except those in which the court may act summarily, and to proceedings and cases under title 11, United States Code.

(c) Rule of privilege. The rule with respect to privileges applies at all stages of all actions, cases, and proceedings.

(d) Rules inapplicable. The rules (other than with respect to privileges) do not apply in the following situations:

(1) Preliminary questions of fact. The determination of questions of fact preliminary to admissibility of evidence when the issue is to be determined by the court under rule 104.

(2) Grand jury. Proceedings before grand juries.

(3) Miscellaneous proceedings. Proceedings for extradition or rendition; preliminary examinations in criminal cases; sentencing, or granting or revoking probation; issuance of warrants for arrest, criminal summonses, and search warrants; and proceedings with respect to release on bail or otherwise.

(e) Rules applicable in part. In the following proceedings these rules apply to the extent that matters of evidence are not provided for in the statutes which govern procedure therein or in other rules prescribed by the Supreme Court pursuant to statutory authority: the trial of misdemeanors and other petty offenses before United States magistrate judges; review of agency actions when the facts are subject to trial de novo under section 706(2)(F) of title 5, United States Code; review of orders of the Secretary of Agriculture under section 2 of the Act entitled "An Act to authorize association of producers of agricultural products" approved February 18, 1922 (7 U.S.C. 292), and under sections 6 and 7(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499f, 499g(c)); naturalization and revocation of naturalization under sections 310-318 of the Immigration and Nationality Act (8 U.S.C. 1421-1429); prize proceedings in admiralty under sections 7651-7681 of title 10, United States Code;

review of orders of the Secretary of the Interior under section 2 of the Act entitled "An Act authorizing associations of producers of aquatic products" approved June 25, 1934 (15 U.S.C. 522); review of orders of petroleum control boards under section 5 of the Act entitled "An Act to regulate interstate and foreign commerce in petroleum and its products by prohibiting the shipment in such commerce of petroleum and its products produced in violation of State law, and for other purposes", approved February 22, 1935 (15 U.S.C. 715d); actions for fines, penalties, or forfeitures under part V of title IV of the Tariff Act of 1930 (19 U.S.C. 1581-1624), or under the Anti-Smuggling Act (19 U.S.C. 1701-1711); criminal libel for condemnation, exclusion of imports, or other proceedings under the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 301-392); disputes between seamen under sections 4079, 4080, and 4081 of the Revised Statutes (22 U.S.C. 256-258); habeas corpus under sections 2241-2254 of title 28, United States Code; motions to vacate, set aside or correct sentence under section 2255 of title 28, United States Code; actions for penalties for refusal to transport destitute seamen under section 4578 of the Revised Statutes (46 U.S.C. 679); actions against the United States under the Act entitled "An Act authorizing suits against the United States in admiralty for damage caused by and salvage service rendered to public vessels belonging to the United States, and for other purposes", approved March 3, 1925 (46 U.S.C. 781-790), as implemented by section 7730 of title 10, United States Code.

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18 U.S.C.A. § 1341. Frauds and swindles

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than five years, or both. If the violation affects a financial institution, such person shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

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18 U.S.C.A. § 1343. Fraud by wire, radio, or television

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be

transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than five years, or both. If the violation affects a financial institution, such person shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

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18 U.S.C.A. § 1961. Definitions

As used in this chapter –

(1) "racketeering activity" means

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section 1341 (relating to mail fraud), section 1343 (relating to wire fraud)

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18 U.S.C.A. § 1962. Prohibited activities

* * *

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

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18 U.S.C.A. § 1964. Civil remedies

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(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee,

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